

National Bank of the Republic of North Macedonia



**Quarterly Report
February 2020**



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Introduction

After the monetary policy relaxation at the end of the first quarter of 2019, the National Bank preserved the key interest rate at 2.25% in the fourth quarter of the year, as well. The current monetary set-up was assessed adequate to the current and projected economic and financial conditions, given sound economic fundamentals and without any imbalance in the economy. The foreign exchange market developments were also favorable in the fourth quarter of the year. The National Bank continued to intervene with net purchase of foreign currency thus increasing the foreign reserves. According to all adequacy indicators, foreign reserves are still in a safe zone. Favorable shifts were also observed in the deposit and credit flows, which show no larger deviations compared to the October projection. At the same time, despite favorable estimates for the domestic economic environment, the growth of the global economy has decelerated, with the global uncertainty still enduring.

The sources of risk remained basically unchanged compared to the October forecasts. The external environment risks associated with escalating trade tensions between the world's major economies and the accompanying uncertainty about the future course of policies are still present, although somewhat more moderate than in October. This assessment is based on the signing of the first phase of the trade agreement between the United States and China and expectations for reduction in protectionist measures, as well as reduced uncertainty over the Brexit process without an agreement. On the other hand, there was pronounced uncertainty from the geopolitical risks, taking into account the developments between the United States and Iran in early 2020. Regarding **the risks associated with the domestic environment, they remain present**, with no significant changes compared to the October forecasts.

The comparison of the latest macroeconomic indicators for the domestic economy with their forecasted dynamics within the October forecast vintage does not indicate major deviations. According to the published estimated GDP data, economic activity continued to grow in the third quarter of the year, with real annual growth rate of 3.6%. The growth dynamics of the domestic economy since the beginning of the year is in line with expectations. There is a slightly lower positive contribution than projected to domestic demand, while the net export effect is more favorable, mainly due to the lower import component. The export of goods and services continue to be the component with the highest individual positive contribution to growth, influenced mainly by the activity of industrial facilities with foreign capital. In addition, the high growth of gross investments also contributed to the growth of economic activity in the third quarter, which is also a driver of the increase in domestic demand, given the favorable developments in the construction sector, with the increase in private consumption also contributing significantly, although more moderately, compared to the growth of the previous quarter. The available data for the fourth quarter for now indicate further growth in the economic activity, although with a somewhat more moderate dynamics than so far. Annually, the October forecast envisages economic growth of 3.5% in 2019 and gradual growth acceleration to 3.8% in 2020 and 4% in 2021. Key factors for growth are the estimations for further solid inflow of new foreign investment in the tradable commodities sector, public investments in road infrastructure, activities of the export-oriented facilities, as well as growth in disposable income and stable household expectations.

The annual increase in domestic prices decelerated from 0.6% in the third, to 0% in the fourth quarter. The inflation in this period is below the expectations for the quarter within the October forecasts. In terms of components, the deviation is largely related to the fall in core inflation as opposed to low growth expectations, while the growth of the food and energy component is generally in line with expectations. **The annual inflation rate equals 0.8% for the entire 2019 and does not deviate significantly from the October forecast of 1% inflation.** The inflation in 2019 was mainly driven by the growth of the food component, as well as by the positive contribution of the core component, while the energy component had a negative contribution. In the conditions of the last quarter performances, which are downward from the projections, as well as mainly upward revisions in the external input assumptions regarding the expected movement of world oil and food prices, the



expected inflation risks for 2020 and 2021 of 1.5 % and 2%, respectively, are currently rated as balanced. The uncertainty about the forecasted movement of the world primary commodities prices remains the main risk surrounding the inflation forecast for the coming period.

The latest available balance of payments data do not indicate any significant deviations with current transactions and financial account flows relative to projections. In the third quarter, the current account surplus was Euro 184 million or 1.7% of GDP. Compared to last year, lower surplus in current transactions was registered, resulting from the deteriorated balance in the foreign trade in goods and services. The other components registered no major changes. At the same time, the financial account recorded net outflows of Euro 42.8 million (0.4% of GDP), which is an improvement compared to the third quarter of 2018. The data on the **gross foreign reserves** for the fourth quarter, as expected, point to quarterly growth, driven also by government borrowing and the National Bank interventions on the foreign exchange market. According to October forecast for the period 2020 - 2021, the foreign reserves will increase on a cumulative basis, and the adequacy indicators will hover in a safe zone.

In the fourth quarter of the year, the **private sector borrowings** registered solid growth, typical for this period of the year, despite the slight decline in the previous quarter as a result of regulatory changes. This period also registered gradual depletion of the effect of the amendments to the regulation of the National Bank to transfer part of the banks' doubtful and contested claims to the off-balance sheet record. Analyzed by sector, credit growth largely stems from the increased credit support to the corporate sector, with lower positive contribution of household loans. Such performances are also in line with the results of the Bank Lending Survey¹ for the fourth quarter that indicate a net increase in total loan demand amid further net easing of total credit standards. On annual basis, at the end of the fourth quarter credit growth reached 6%, which is above the projected annual growth in October forecasts (5.4%). In terms of funding sources, **favorable movements in total deposits** continued in the fourth quarter. Higher money supply in the economy during this period is common and in part is associated with certain seasonal factors, partly reflecting improved performance in the domestic economy. Analyzing by sector, the deposit increase is primarily due to the growth of household deposits amid solid growth of corporate deposits. The annual growth of total deposits at the end of December was solid and amounted to 9.0%, and is being slightly lower than expected with the October forecasts (of 9.6%). In the next period, it is expected that the banks' deposit base will continue to grow, providing stable sources for financing the credit growth.

In general, the latest macroeconomic indicators and assessments do not deviate much from the forecasts. The environment for conducting monetary policy remains stable, with sound economic bases and absence of imbalances in the economy. The banks' lending activity is expected to further support the domestic economy, in the absence of inflationary pressures and favorable external position, which will enable maintenance of foreign reserves in the safe zone. The growth of the economy in the third quarter of 2019 is solid and in line with the expected, and the signals from the available high frequency data on the economic activity are in line with the expectations for more moderate economic growth in the last quarter. In the period ahead, the National Bank will continue to carefully monitor the performance and potential risks from the domestic and external surrounding in the context of the monetary policy setup.

¹ For more information, also see [Bank Lending Survey](#).



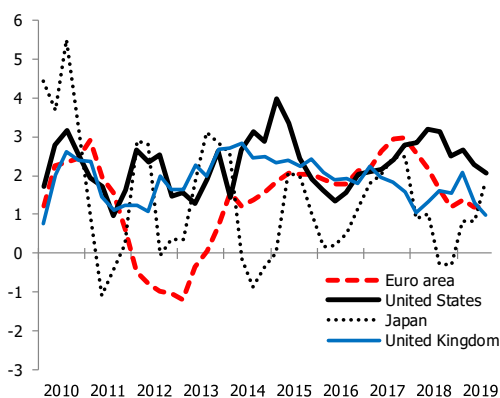
I. Macroeconomic developments

1.1. International Economic Surrounding²

Global economic growth continued in the third quarter of 2019 as well. In emerging countries, economic growth is slightly lower than expected, while in the group of developed countries the dynamics of economic activity does not diverge significantly from the forecasts. The growth in euro area, as our most important trading partner, was stable and it equaled 1.2%. Stabilization of the global growth trend is expected for the fourth quarter. According to the latest estimates, the global economy will slow down from 3.6% in 2018 to 2.9% in 2019, while moderate recovery and growth rates of 3.3% and 3.4% are expected in the coming period in 2020 and 2021, which is a slight downward revision compared to the October estimates. Risks to global economic growth are assessed as slightly favorable, but remain largely downward.

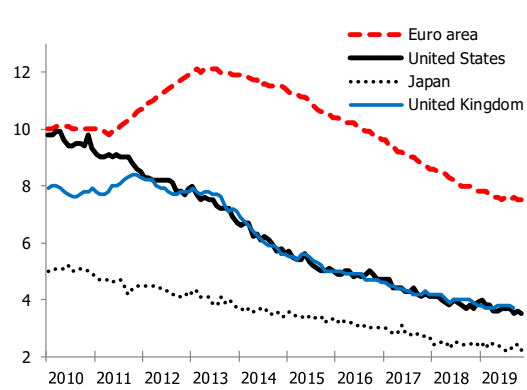
Global economic activity continued to grow in the third quarter of 2019. Analyzed by country, Japan's economic growth accelerated compared to the second quarter, which was not the case with the euro area, whose annual growth rate remained at 1.2%, as well as the UK and US, which recorded slight slowdown in growth dynamics amid prolonged uncertainty associated with increased protectionism and further poor global trade. The Japanese economy acceleration from 0.8% in the second to 1.9% in the third quarter is mainly due to the solid growth of investment in fixed assets, while in the export sector performance was slightly weaker due to the slowing global economic activity. The growth in the euro area was steady and driven by domestic demand. The slowdown in US economic activity in the third quarter (2.1% compared to 2.3% in the previous quarter) is largely due to the slower growth in gross investment and private consumption, partially neutralized by more favorable net export movements. The UK's annual economic growth rate in the third quarter equals 1% (1.3% annual growth in the second quarter) and is the weakest growth rate since the first quarter of 2010, in the conditions of further uncertainty associated with Brexit and global trade tensions, with the decline in gross investment being the main factor for growth deceleration.

Real GDP growth in advanced economies
(year-on-year percentage changes; quarterly data)



Source: OECD.

Unemployment in advanced economies
(in percent; seasonally adjusted monthly data)



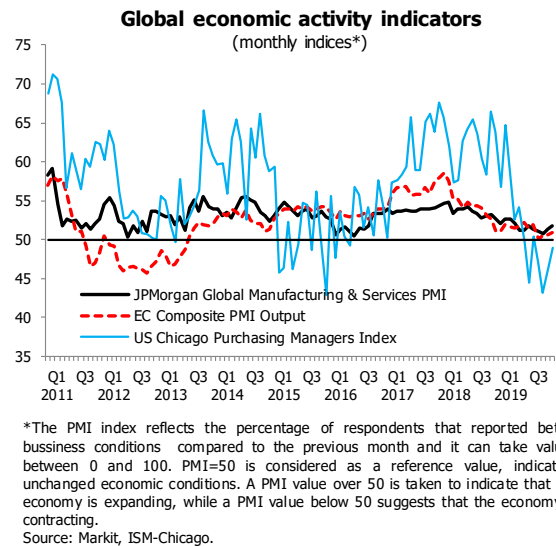
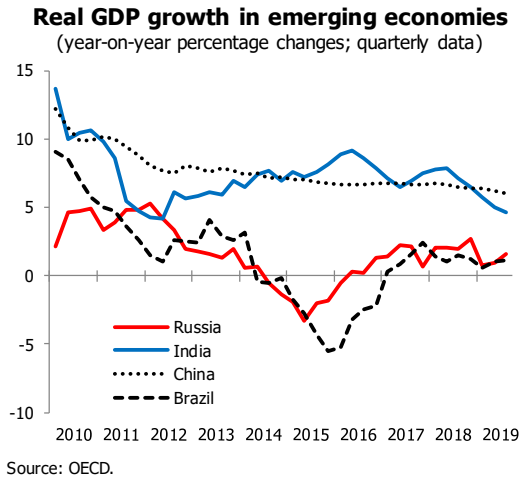
Source: Eurostat.

Movements in different directions were also registered in emerging economies. Thus, China's growth slowed further, with the annual rate in the third quarter being reduced to 6% (6.2% in the second quarter), the lowest growth rate since 1992. Such a move is due to weaker

² The analysis is based on the IMF's *World Economic Outlook* of October 2019; the ECB's *Economic Bulletin*, the announcements of *Markit Economics*, the World Bank's *Global Economic Prospects*, the reports of *Bloomberg*, *Roubini Global Economics*, *Capital Economics*, *Reuters* and *Trading Economics*, the monthly reports of the International Energy Agency and the weekly reports of the Bank of Greece.



domestic and foreign demand amid further trade tensions between this country and the United States. The Indian economy also registered a slower growth (4.7% annual growth in the third quarter compared to 5% in the previous quarter), amid weaker domestic demand, as well as slower production and decline in exports due to the slowdown in the global economy. On the other hand, in the third quarter, Russia and Brazil registered acceleration in the economic growth. Thus, the annual growth rate in Russia reached 1.6% (0.9% in the second quarter), mainly as a result of growth in industry, agriculture and wholesale trade, while the Brazilian economy registered a minimal growth rate of 1.2% in the third quarter entirely due to stronger household consumption.



In terms of growth estimations in the last quarter of the year, the currently available high-frequency survey indicators point to slightly less favorable movements compared to the third quarter. Thus, the average value of the PMI index in the period October-November was 51.2 (51.4 in the third quarter), which indicates a possible further slowdown of the global economy by the end of the year.

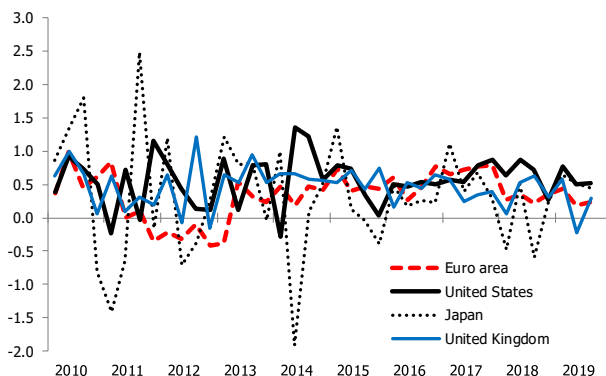
The latest IMF perceptions from January 2020 say that the global economic growth in 2019 will slow down and equal 2.6% (3.6% growth in 2018), and for 2020 and 2021 it is expected to moderately decelerate to 3.3% and 3.4%, respectively. The recovery of global growth in the future will be supported by the positive effect of monetary easing in developed and emerging economies in 2019 and stronger growth in world trade, reflecting a recovery in domestic demand, especially investment, as well as reduction of some temporary unfavorable factors in the car and technology industries. Compared to the October forecasts, growth expectations have been revised downwards for all three years (by 0.1 percentage point in 2019 and 2020 and by 0.2% in 2020), as a result of the less favorable performance the group of emerging countries.

The risks in terms of projected global economic growth are again downward, but are assessed as slightly more favorable than the previous estimate. Such assessments are mainly linked to the emergence of the first signs of growth stabilization in manufacturing sector and global trade, expectations for a positive effect of relaxed monetary policy in many countries in the second half of 2019, as well as the signing of the first phase of the trade agreement between the USA and China, as well as reduced uncertainty over Brexit after the early elections in the United Kingdom. On the other hand, geopolitical risks deteriorated, reflecting developments in the Middle East. Also, the possible escalation of trade tensions between the world's largest economies could lead to poor realization of economic activity in the most important economies than expected, as well as worsening of global financial conditions and increased financial vulnerability in emerging and developing countries.



In terms of global inflation, in 2019 the price growth is generally slightly lower than in 2018, with no significant price pressures by the end of the year being expected, amid falling world oil prices and a slight rise in the food price index in the last quarter, as well as weak global demand.

Real GDP growth in advanced economies
(quarter-on-quarter percentage changes)



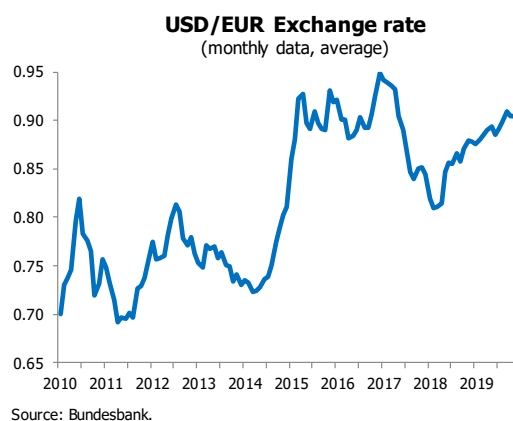
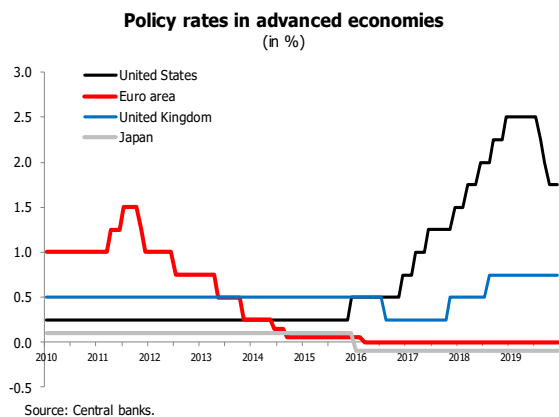
Source: OECD.

In the third quarter of the year, the annual growth rate of the euro area equaled 1.2% (0.2% on a quarterly basis) and remained unchanged relative to the rate in the second quarter. Of the individual member states, the weakest economic growth was registered in Germany and Italy. Analyzed by components, domestic demand continues to show resilience to developments in the manufacturing sector, while net exports have a negative contribution, amid low export growth, amid increased global uncertainty, weaker foreign demand and stronger import growth. Labor market movements remain favorable, with the number of employees growing by 1% in the third quarter (1.2% in the second quarter), while the unemployment rate remained at the level of the previous quarter (7.6%). According to the latest ECB projections, real GDP growth in the euro area is expected to be 1.2% in 2019, then slowdown to 1.1% in 2020, while for 2021 and 2022 it is expected to increase slightly by 1.4%. Thereby, for 2020, downward adjustments have been made relative to the September forecasts, in conditions of higher downward revision of foreign demand, which will be partially neutralized by fiscal and monetary policy support³. **The annual inflation rate in the euro area in the period October-November remained at the level of 0.9%, same as in the third quarter**, amid acceleration of the core inflation and stronger fall in the energy price. Thus, for the whole of 2019, according to the latest ECB projections, inflation rate of 1.2% is expected, and similar growth of prices is expected for 2020 (1.1%). In the medium run, gradual acceleration of inflation is expected, which is expected to be 1.4% in 2021 and to reach 1.6% in 2022⁴.

In the last quarter of 2019, monetary policy in developed countries preserved the stimulating set-up. In October, FED cut interest rates by 25 basis points for the third time, down from 1.50% to 1.75%, due to expected adverse effects of global movements on the domestic economy and disinflationary pressures. Until the end of the year, the monetary policy remained unchanged, and according to the view of the members of the Monetary Policy Committee on the future path of the reference interest rate, it is expected to remain at that level in 2020, as well. The European Central Bank has made no change in its monetary policy set-up, given the large stimulus package announced in September, which envisages purchase of securities in the amount of Euro 20 billion on a monthly basis from 1 November. At the same time, after the December meeting, it was announced that the ECB's strategy would be discussed, a process that will begin in January and is expected to be completed by the end of 2020. Bank of England and Bank of Japan did not make any changes to the monetary policy setup.

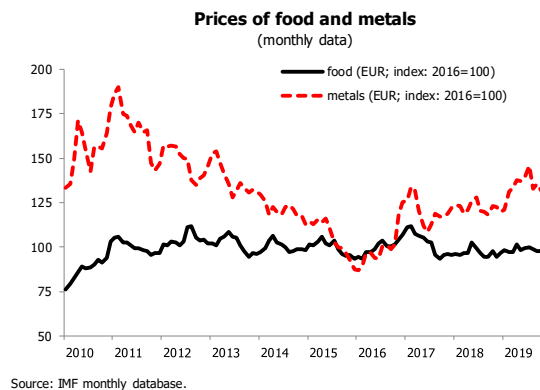
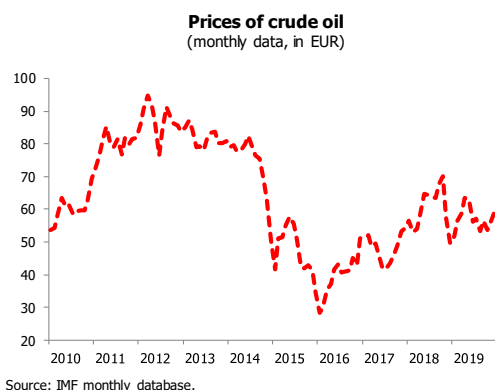
³ In December, the ECB revised the September forecasts for 2019 and 2020, estimating that the euro area real GDP growth will be 1.1% in 2019 and 1.2% in 2020 and the forecast for 2021 will remain unchanged.

⁴ In December, the ECB revised the September forecasts, estimating that the euro area inflation will be 1.2% in 2020 and 1.5% in 2021 and the forecast for 2019 will remain unchanged.



In the fourth quarter of 2019, the value of the US dollar against the euro, on average, remained unchanged compared to the third quarter. Thus, on average, the US dollar was traded at Euro 0.9, which is an annual appreciation of 3.2% against the euro. The movements in the US dollar were mainly influenced by the varying information about the signing of the first phase of the US - China trade agreement.

In the fourth quarter of 2019, oil prices averaged Euro 56.6 per barrel, registering a slight increase of 1.7% compared to the previous quarter, decreasing by 4.1% on annual basis. The quarterly increase is a result of favorable developments in US - China trade relations with the signing of a trade agreement and market perceptions for higher oil demand, as well as the decision of OPEC + member states to further reduce daily oil production⁵.



The prices of the non-energy primary goods⁶ (denominated in euros) in the last quarter of 2019 remained almost unchanged compared to the third quarter. Analyzed by group of products, metals prices declined and food prices increased. Namely, the basic metals index⁷ decreased by 5.8% on a quarterly basis, whereby the price of iron ore registered the largest drop, reflecting the growth deceleration of the Chinese economy. In contrast, the food price index⁸ rose by 2.1% compared to the third quarter, within which an increase was registered in cereals, given strong demand, late harvest in the United States and less favorable weather conditions in parts of the northern hemisphere, as well as unfavorable production prospects for southern hemisphere. Observed on an annual basis, euro prices of primary non-energy products increased by 8.1%.

⁵ At their meeting from 6 December 2019, the OPEC+ member countries made a decision to reduce the daily production by additional 500.000 barrels per day from previously agreed (1.200.000 barrels per day from December 2018), whereby the decision will apply from 1 January 2020 until the end of March.

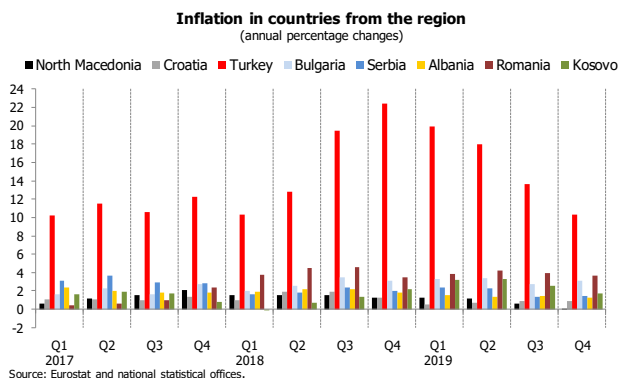
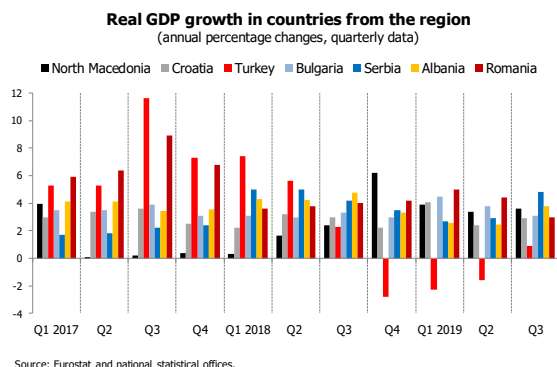
⁶ This aggregate index includes the precious metals index, the index of food and beverages, the index of agricultural raw materials and the index of basic metals.

⁷ This index includes the following metals: aluminum, cobalt, copper, iron, lead, molybdenum, nickel, tin, uranium and zinc.

⁸ This index includes the following primary food products: cereals, vegetable oil, meat, seafood, sugar and other foods.



In terms of macroeconomic performance in the economies of the region, in most of the countries, economic activity accelerated in the third quarter of 2019. Serbia had the highest growth in the region (4.8%), which is an acceleration of almost 2 percentage points, mainly due to the strong investment activity. Albania also registered accelerated growth, as a result of the accelerated growth of private consumption and exports, as well as Croatia, mainly due to the positive net exports. Turkey registered slight growth, despite a decline in the previous three quarters, amid more favorable domestic demand. The slowdown in economic activity was registered in Bulgaria and Romania, due to the slower growth in private consumption and the slower decline in Bulgaria's imports, i.e. the stronger fall in inventories in Romania.



In the fourth quarter of 2019, the annual inflation rate in most of the countries in the region is relatively stable, while in some of them, the prices show intensified growth slowdown. Thus, in Croatia, the inflation rate remained unchanged compared to the third quarter, while prices in Serbia were minimally higher as a result of the higher rise in energy and food prices. In Romania and Albania, inflation rates are minimally lower, mainly due to lower growth in core inflation in Romania, and in Albania due to stronger energy declines and weaker core inflation growth. Turkey's inflation has been slower, due to lower food prices and core inflation, as well as Kosovo, largely due to the slower growth in the food component. On the other hand, prices in Bulgaria registered stronger growth compared to the previous quarter amid higher food prices.

1.1 Domestic supply

According to published estimated GDP data, domestic economic activity continued to grow in the third quarter of 2019 as well, at a faster pace, reaching a real annual growth rate of 3.6% (3.4% in the second quarter). The largest positive contribution to the growth of value added of the economy was made by industry, followed immediately by the group of "trade, transport and catering" activities, complemented by the growth of construction and "real estate activities". The available data for the period October - November on the supply side generally point to favorable developments in the last quarter of the year. In line with the positive developments in the domestic economy, the perceptions of the managers in retail, construction and manufacturing industries indicate favorable expectations for the following period.

In the third quarter of 2019, the domestic economy registered a solid rate of real economic growth of 3.6% on annual basis (slight acceleration compared to the growth of 3.4% in the second quarter), i.e. growth of 1.1% on quarterly basis (seasonally adjusted). Most of the activities recorded positive growth rates, with industry having the highest individual



contribution, mainly due to the favorable performance in the energy sector. The group "trade, transport and catering" also has a high positive contribution to economic growth, followed by the construction sector and "real estate activities"⁹.

Annual growth rates (in %)

	annual growth rates, in %										
	2015	2016	2017	2018	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019
Agriculture	1.9	-0.4	-12.5	7.4	11.3	-1.7	6.0	13.5	9.6	3.6	0.8
Industry	4.9	-3.0	1.4	4.1	0.7	3.5	4.3	7.6	5.7	4.3	6.8
Manufacturing	5.0	-1.5	1.6	4.5	6.8	1.8	3.2	6.6	1.9	-0.7	-0.5
Construction	8.0	-2.8	1.6	-11.9	-20.6	-14.9	-17.1	1.9	6.7	4.8	5.5
Trade and transport	1.4	8.7	7.1	5.9	3.9	7.5	5.2	7.1	4.0	2.2	4.9
Information and communication	13.4	7.2	7.6	-6.4	-10.7	-2.5	-6.1	-6.3	-5.5	-6.1	2.2
Financial and insurance activities	8.7	1.5	1.9	2.6	3.4	1.6	2.8	2.4	-0.7	0.6	0.4
Real estate activities	2.7	-3.2	-1.6	0.1	0.2	1.4	0.8	-2.0	3.7	4.2	2.4
Professional, scientific and technical activities	5.9	11.5	8.8	7.5	16.1	6.3	3.9	4.0	-0.1	3.6	4.5
Public administration	6.5	3.5	-2.2	2.6	0.5	2.7	3.8	3.6	5.6	3.6	1.2
Other service activities	4.5	7.2	3.1	3.0	8.4	3.2	-0.4	0.6	-8.6	-3.8	1.0
Gross Domestic Product	3.9	2.8	1.1	2.7	0.3	1.7	2.4	6.2	3.9	3.4	3.6

*From the release for GDP of 06.12.2019
Source: State Statistical Office and NBRNM calculations.

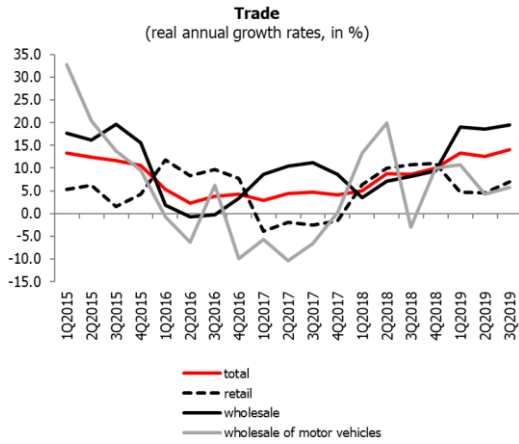
Contributions to the GDP growth (in percentage points)

	contribution in GDP growth, in p.p.										
	2015	2016	2017	2018	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019
Agriculture	0.2	0.0	-1.1	0.6	0.7	-0.1	0.5	1.2	0.6	0.2	0.1
Industry	0.8	-0.5	0.2	0.7	0.1	0.6	0.7	1.4	1.0	0.8	1.2
Manufacturing	0.5	-0.2	0.2	0.6	0.7	0.2	0.4	0.9	0.2	-0.1	-0.1
Construction	0.6	-0.2	0.1	-0.8	-1.1	-0.9	-1.2	0.1	0.3	0.3	0.3
Trade and transport	0.3	1.6	1.3	1.2	0.8	1.5	1.0	1.4	0.8	0.4	1.0
Information and communication	0.4	0.2	0.2	-0.2	-0.4	-0.1	-0.2	-0.2	-0.2	-0.2	0.1
Financial and insurance activities	0.3	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Real estate activities	0.3	-0.4	-0.2	0.0	0.0	0.1	0.1	-0.2	0.5	0.4	0.2
Professional, scientific and technical activities	0.2	0.4	0.3	0.3	0.6	0.2	0.1	0.1	0.0	0.1	0.2
Public administration	0.8	0.4	-0.3	0.3	0.1	0.3	0.4	0.4	0.7	0.4	0.1
Other service activities	0.1	0.2	0.1	0.1	0.2	0.1	0.0	0.0	-0.3	-0.1	0.0
Gross Domestic Product	3.9	2.8	1.1	2.7	0.3	1.7	2.4	6.2	3.9	3.4	3.6

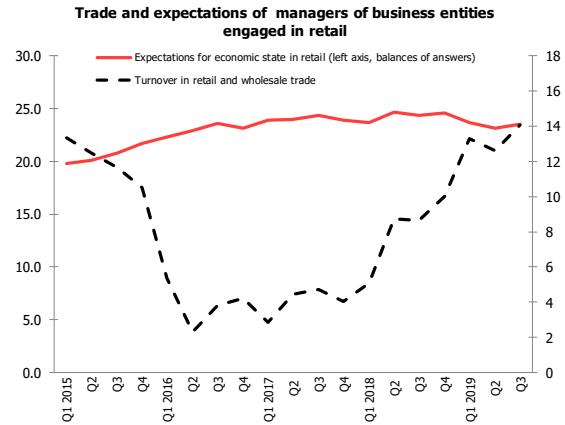
*From the release for GDP of 06.12.2019
Source: State Statistical Office and NBRNM calculations.

The trade turnover registered solid and accelerated annual growth of activity in the third quarter. Thereby, this favorable performance has been registered in all three types of trade, i.e. "retail", "wholesale" and "motor vehicle trade". In the period October - November, total trade turnover continued to grow, with the intensity being slightly more moderate compared to the annual growth in the previous quarter. According to the positive performance in the trade, the expectations of the managers in the "retail trade" sector for the forthcoming period in terms of orders, sales prices, as well as the number of employees are favorable.

⁹ Positive contribution to the economic growth are also the activities "administrative and auxiliary services", "agriculture, forestry and fishery" "public administration and defense; compulsory social security; education; health and social care activities "and" information and communications ".

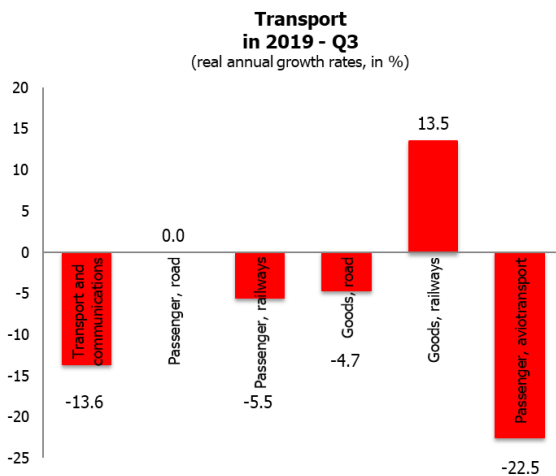


Source: State Statistical Office and NBRNM.

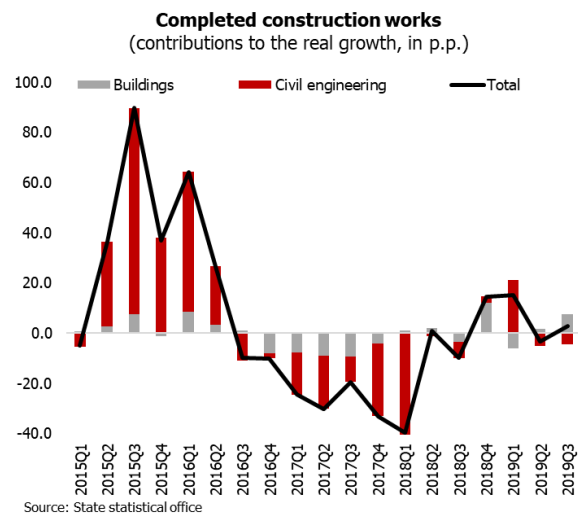


Source: State Statistical Office and NBRNM.

Regarding **transport**, activity growth in the third quarter was registered only in passenger air traffic (slight slowdown in the annual growth rate compared to the second quarter), while the annual growth rate of passenger rail traffic remained unchanged compared to the previous quarter. The other types of transportation recorded an annual decline in activity, which is particularly pronounced in freight air traffic (after high annual growth in the second quarter) and passenger road traffic (slight slowdown compared to the decrease in the second quarter).

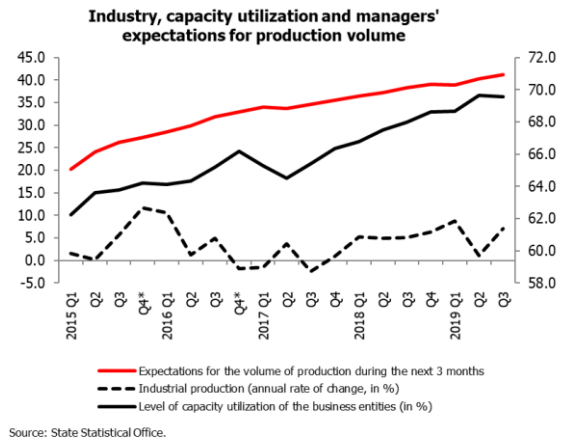


Source: State Statistical Office.

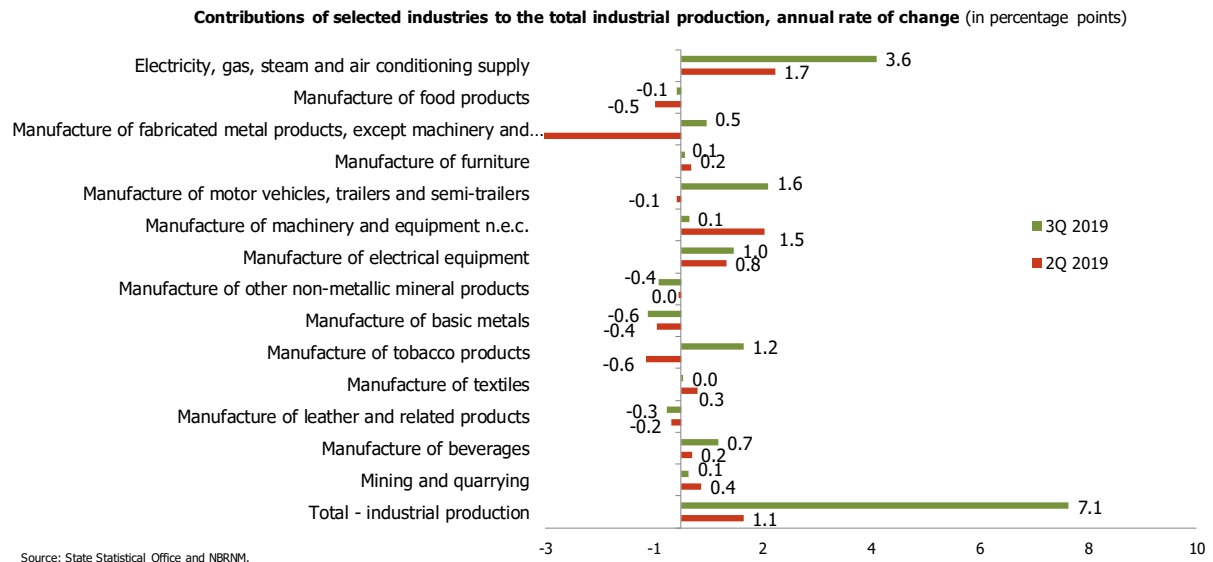


Source: State statistical office

In the third quarter of the year, the construction sector made a positive contribution to the overall economic growth. Thus, based on high frequency data, in the third quarter the construction sector registered real annual growth (despite the decline in the second quarter), as a result of the performance in structural engineering (particularly significant acceleration of activity compared to the second quarter), while civil engineering registered a further, albeit more moderate, decrease on an annual basis, which in conditions of high quarterly growth is due primarily to high and a comparative basis from the same period last year. In October activity in the construction sector continued to grow at a similar annual pace as in the third quarter of 2019, amid growth in civil engineering, while structural engineering had a negative contribution. Expectations of construction managers in terms of sales prices, total orders and number of employees for the coming period are also favorable.



Acceleration in the dynamics of annual growth is also observed in the industry. The largest positive contribution to the growth of total industrial production was made by the energy sector, supplemented by a solid contribution from the manufacturing industry¹⁰. Within the manufacturing industry, the main drivers of growth are mainly the activities where the larger foreign export capacities are active, with the most significant contribution to the growth of the production of motor vehicles and electrical equipment. Part of traditional production also has a positive contribution, such as the production of tobacco products, production of beverages, as well as the production of "fabricated metal products other than machinery and equipment. In the period October - November, the industrial output registered moderate growth of 1.0% on annual basis, while the annual growth slowed down due to the negative performance in the energy sector and mining, while the manufacturing industry was characterized by accelerating growth. As with other sectors, industry managers have favorable expectations for the developments in manufacturing, sales prices and number of employees in the following period.



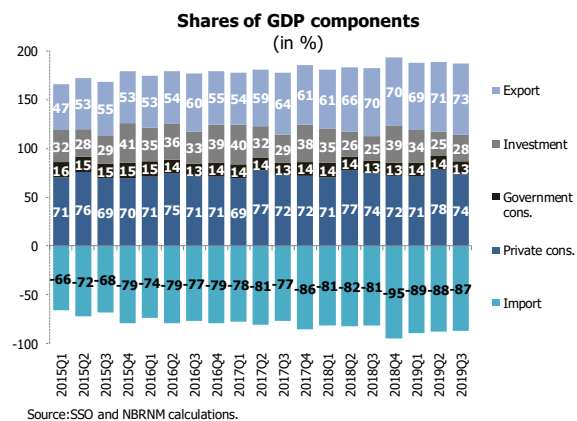
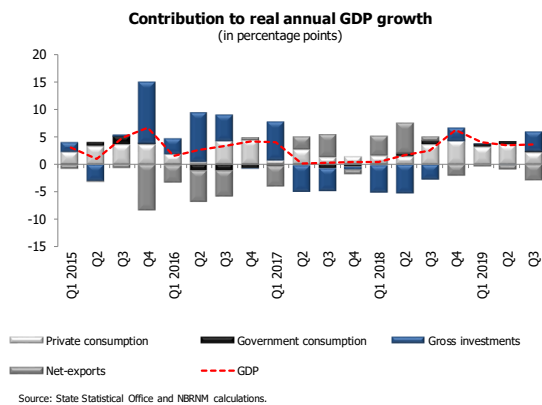
¹⁰ The analysis of trends in industry uses data on the SSO's monthly data for the industrial output indices.



1.2 Aggregate demand

In terms of demand, the annual GDP growth of 3.6% in the third quarter of 2019 is driven by domestic demand, given the significant contribution of gross investments and private consumption, and growth of public consumption. After the slight decline in the gross investments in the second quarter, this quarter they registered accelerated growth, which corresponds to the further growth of value added in construction. The solid growth of private consumption continued in the third quarter, supported by the accelerated growth of disposable income, as well as the growth of crediting to households. As before, exports continue to be the category with the highest individual positive contribution to the growth of the domestic economy, largely due to the activity of foreign export industrial facilities. Export growth, coupled with increased domestic demand, led to the growth of import of goods and services, with net exports also contributing negatively to GDP change this quarter.

Structural analysis of GDP components¹¹ in terms of demand shows that as in the previous quarter, growth is due to domestic demand, where the main drivers are gross investment and private consumption, and public consumption has a less positive contribution. The shifts in investments correspond to the changes in value added of construction, which is growing, mainly due to favorable shifts in construction. On the other hand, export growth slows down, but it remains the category with the highest individual contribution to GDP growth. However, given the simultaneous growth of imports, with similar dynamics as in the second quarter, net exports have a negative contribution to the overall economic growth.



¹¹ The quarterly changes in GDP and its components are calculated by using seasonally adjusted data.



	Real annual growth rates (%)										Contributions to real annual growth (in p.p.)**											
	2015	2016	2017	2018	2018-Q1	2018-Q2	2018-Q3	2018-Q4	2019-Q1	2019-Q2	2019-Q3	2015	2016	2017	2018	2018-Q1	2018-Q2	2018-Q3	2018-Q4	2019-Q1	2019-Q2	2019-Q3
Private consumption	4.4	3.9	2.1	3.7	2.1	1.8	4.8	5.8	4.4	4.4	2.9	3.1	2.7	1.4	2.4	1.4	1.2	3.2	3.8	2.8	3.0	1.9
Government consumption	3.9	-4.9	-2.6	2.0	-0.9	3.6	5.4	0.3	3.8	4.8	2.0	0.7	-0.8	-0.4	0.3	-0.1	0.5	0.7	0.0	0.6	0.7	0.3
Exports of goods and services	8.5	9.1	8.3	15.6	14.1	14.5	11.8	21.6	17.8	11.7	8.3	4.0	4.4	4.2	8.6	6.9	7.9	7.1	12.2	9.9	7.0	5.2
Imports of goods and services	9.9	11.1	5.2	9.1	4.9	3.6	8.7	17.7	13.8	10.4	10.7	-6.5	-7.2	-3.4	-6.2	-3.3	-2.5	-5.7	-13.1	-9.6	-7.4	-7.5
Gross capital formation	8.3	12.5	-2.2	-7.3	-12.5	-16.8	-9.4	6.4	0.1	-0.3	14.1	2.5	3.8	-0.7	-2.4	-4.5	-5.0	-2.7	2.4	0.4	-0.6	3.1
Domestic demand	5.4	5.1	0.3	0.3	-3.0	-2.8	1.3	5.4	3.1	3.4	5.3	6.3	5.6	0.3	0.4	-3.3	-3.2	1.3	6.2	3.8	3.2	5.3
Net exports*	14.1	16.7	-2.7	-9.4	-15.4	-25.3	-6.9	8.1	2.1	5.4	25.1	-2.4	-2.8	0.8	2.3	3.7	5.4	1.4	-0.8	0.3	-0.4	-2.3
Statistical discrepancy												0.0	0.0	0.0	0.0	-0.1	-0.5	-0.3	0.8	-0.2	0.6	0.6
GDP	3.9	2.8	1.1	2.7	0.3	1.7	2.4	6.2	3.9	3.4	3.6	3.9	2.8	1.1	2.7	0.3	1.7	2.4	6.2	3.9	3.4	3.6

*decrease represents lower deficit

** Contribution components do not sum to total GDP due to statistical discrepancies in real amounts.

In order to comply with the official real growth rates, the statistical discrepancy is included in the aggregate GDP.

Source: SSO and NBRNM calculations.

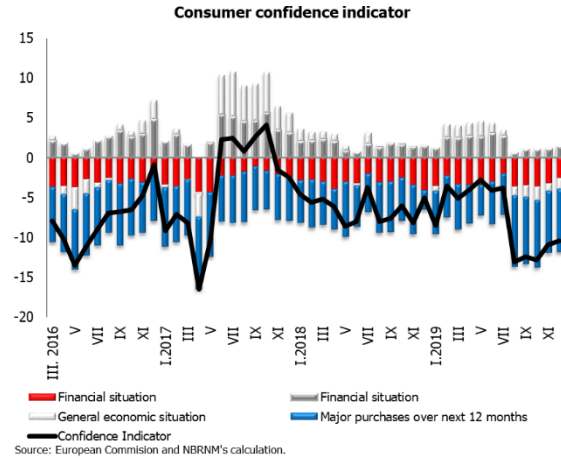
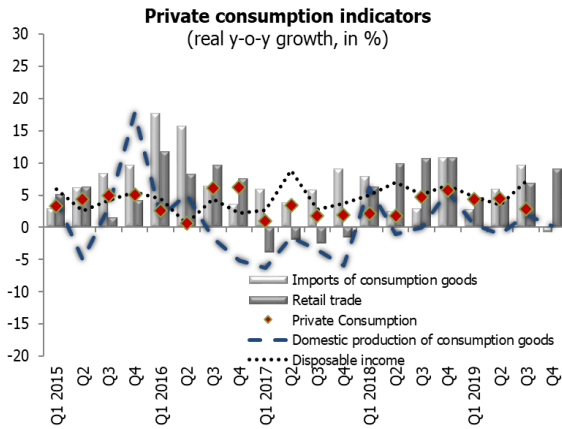
1.2.1 Private consumption

Growth of private consumption continued in the third quarter of 2019, but at a slightly slower annual pace compared to the growth in the first half of 2019. The realized annual growth rate of private consumption in the third quarter equaled 2.9%, while quarterly growth rate was 1.1%. Favorable movements of all components of disposable income acted to support the growth of private consumption. Namely, the third quarter of the year recorded a further increase in the supply of wages and pensions with positive contribution of the increase in private transfer in this quarter. Besides the disposable income, the growth of private consumption was complemented by the solid growth of lending to households by banks.

The signals from the available high-frequency data have indicate further growth of private consumption¹² in the second quarter of 2019. Thus, in the period October - November, retail trade, real wages and pensions increased, with the lending to households also registering solid increase. This corresponds with the results of the Lending Survey, which indicate a moderate easing of the total lending conditions and a net increase in the households demand for loans in this period. Also, during this period, VAT revenues increased as a reflection of the consumption, as well as domestic production of consumables, while imports of consumer goods declined slightly. On the other hand, signals from consumer confidence surveys¹³ conducted in the fourth quarter indicate a reduced confidence amid higher purchases and unfavorable expectations regarding the general economic situation, as well as perceptions of less favorable household finances.

¹² From the indicators for personal consumption, data on turnover in retail trade, pensions, domestic production of consumer goods, imports of consumer goods and household loans refer to the period October - November 2019, while net wages are as of October 2019.

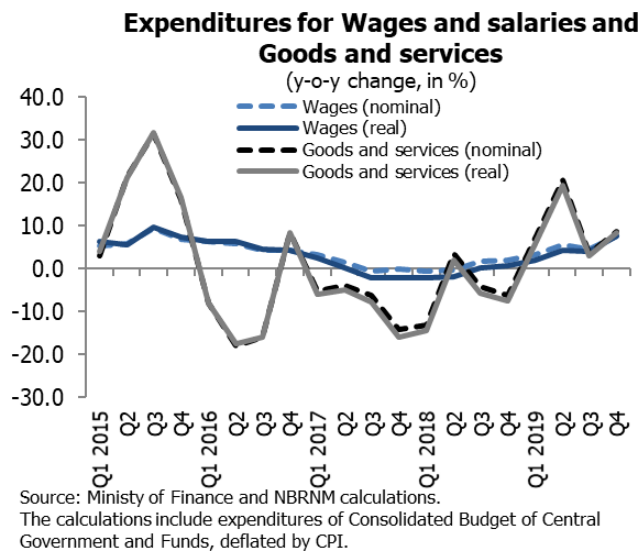
¹³ European Commission's Consumer Survey as of December 2019. The chart shows the consumer confidence index as a net percentage of responses. This index is an integral component of the total index of economic confidence. Starting from January 2019, the European Commission revised the structure of consumer confidence indicator, and accordingly, the composite indicator of economic confidence. For more information on the new methodological changes visit: https://ec.europa.eu/info/files/revised-consumer-confidence-indicator_en



1.2.2 Public consumption

In the third quarter of 2019, public consumption continued to grow, but at a slower annual growth rate of 2.0% (4.8% in the previous quarter), amid a quarterly decline (of 2.1%). According to budget data, the annual growth of public consumption in the third quarter is explained by higher wage expenditures (with an additional 5% increase in total public administration wages since September), transfers to local authorities, transfers to the health fund, as well as higher expenditures for goods and services¹⁴.

Budget performances in the period October - November 2019 point to further annual growth of **public consumption** also in the fourth quarter, amid growth in the main categories¹⁵ of public spending.



1.2.3 Investment consumption

In the third quarter of 2019, the gross investments registered intensified annual and quarterly growth of 14.1% and 17.2%, respectively. Such favorable developments follow the slight decline in the second quarter, which occur in the conditions of a relatively low comparative

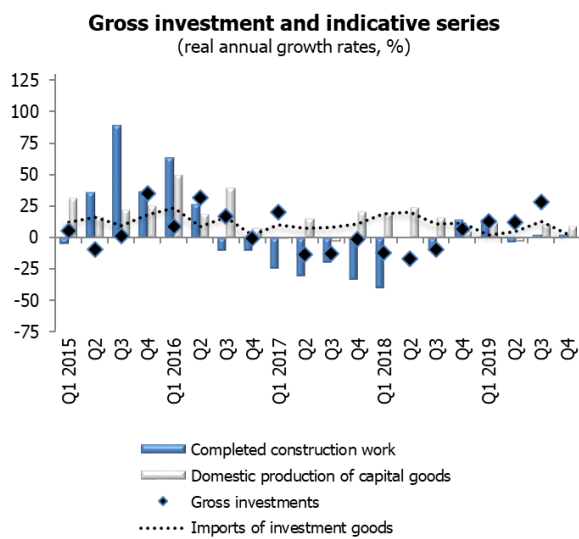
¹⁴ Out of the public consumption components, only transfers to PDINM decreased in the third quarter of 2019.

¹⁵ In the period October-November 2019, a decline was observed only in the transfers to the Employment Service Agency.

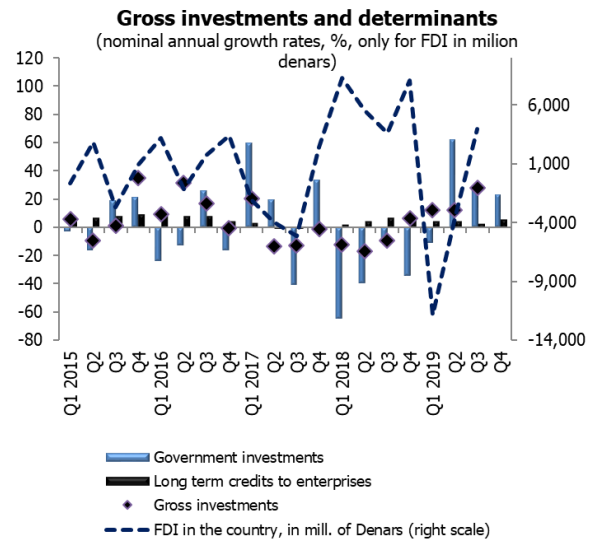


basis from last year and are in line with the growth of value added in the construction sector, amid favorable developments in structural engineering. In the domain of civil engineering, movements within the quarter are characterized by a higher degree of volatility, however, cumulatively for the whole third quarter, a reduced value of the completed construction works is registered. Growth in gross investment was additionally supported by the growth of long-term corporate lending in the third quarter of the year.

In terms of the movement of investments¹⁶ in the fourth quarter of 2019, most of the high-frequency data indicate favorable movements. Namely, annual growth of the short-term investment indicators has been registered with the government capital investments and the domestic manufacturing of capital products. At the same time, corporate lending in the period October-November registered accelerated growth, amid increased loan demand and net easing of credit standards in this period, as shown by the results of the banks' surveys. Also, although significantly slower, growth was registered in industrial output and import of investment products, with the activity in the construction sector, after the fall in September, also increasing in October. On the other hand, the only decline was registered in corporate tax.



Source: State Statistical Office, Ministry of Finance and NBRNM calculations.



Source: State Statistical Office, Ministry of Finance and NBRNM calculations.

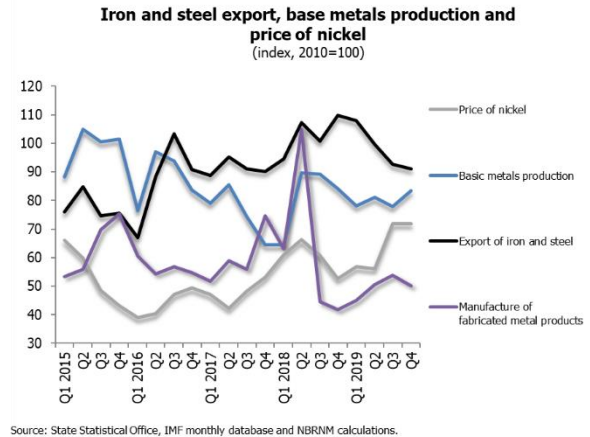
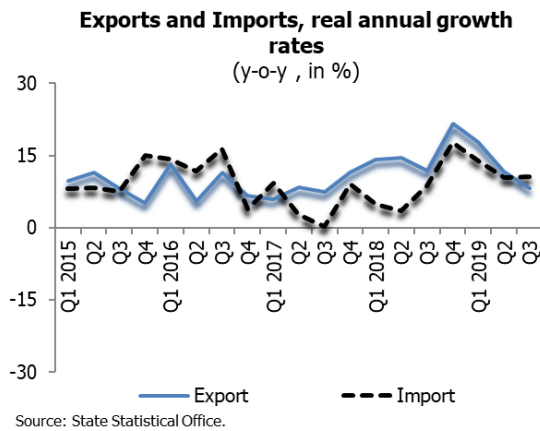
1.2.4 Net external demand

The contribution of net exports to the domestic economy growth in the third quarter of 2019 was negative. Despite the slower annual export growth of 8.3% in the third quarter, conditioned by the quarterly decline of 1.8%, it remains to be the component with the highest individual positive contribution to GDP growth. Analyzed by high frequency foreign trade statistics, the growth of the nominal export was mostly supported by the solid performance of the new export-oriented industrial facilities and the energy export. However, the increase in exports, together with the increase in investment demand and private consumption, also led to annual and quarterly growth of imports of 10.7% and 4.6% respectively, which contributed to a negative contribution of net exports.

¹⁶ Out of the gross investments indicators, data on the government capital investments, domestic production of capital goods, import of means for operation and long-term corporate loans are as of October - November 2019, while data on completed construction works, direct investments, and stocks of manufactured articles are as of October 2019.



In the period October - November 2019, foreign trade data indicate potential deficit expansion in the fourth quarter compared to the same period last year, in conditions of growth of the import and fall in the export of goods.



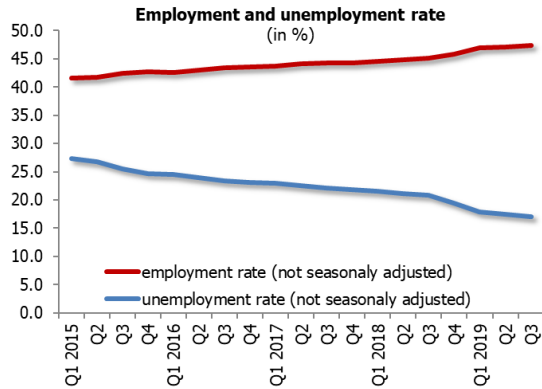
1.3 Employment and wages

Labor market indicators in the third quarter of 2019 show a further increase in the number of employees and a continuing downward trend in the unemployment rate. Namely, employment in this quarter also grew at a solid annual growth rate of 5.3%, while the unemployment rate reduced to 17.1%. The business tendency surveys mainly point to increased optimism about employment for the next three months. In terms of labor supply, the annual growth of the active population continued, a trend that has been present since the last quarter of 2016. In terms of competitiveness indicators, labor productivity continued to decline, while unit labor costs continued to rise.

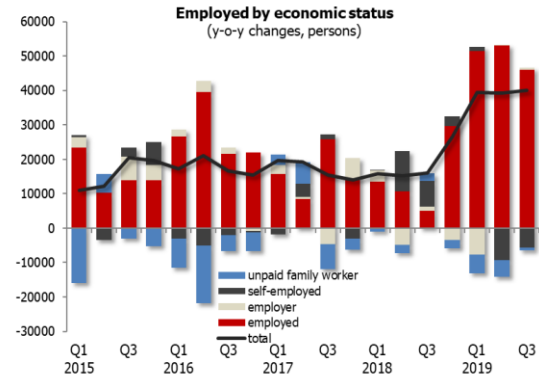
The employment growth continued in the third quarter of 2019, again at similar growth pace as in the previous quarter. Thus the number of employed persons increased by 5.3%, on annual basis and by 0.3%¹⁷, quarterly. By activity, "administrative and auxiliary service activities", "arts, entertainment and recreation" activities, "accommodation and food service activities" and "other service activities" contribute the most to the the annual growth. The manufacturing industry, construction and trade also have an additional significant contribution to the annual employment growth. A reduced number of employees is registered in only a few activities, most notably in the fields of "agriculture", "transport and storage", and "information and communications". Regarding the economic status¹⁸, the increase in the number of employees is largely explained by the category of "employees".

¹⁷ Analysis of quarterly dynamics of employment, unemployment and total active population is made by using seasonally adjusted data.

¹⁸The classification by economic status applies to the following groups: **employers** - persons who operate their own business entity or engages independently in their own shop, or farm owners who hire other employees; **employees** - persons who work in government institutions, business entities in public, mixed, cooperative and undefined ownership or for private employer; **own-account workers** - persons who operate their own business entity, company, engage independently in their own business and work on a farm in order to generate income, while not hiring other employees; **unpaid family workers** - persons who work without pay in a business entity, shop or farm (owned by a family member).

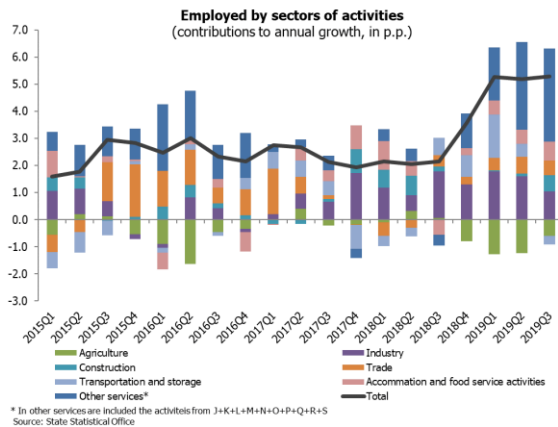


Source: State Statistical Office, Labour Force Survey.

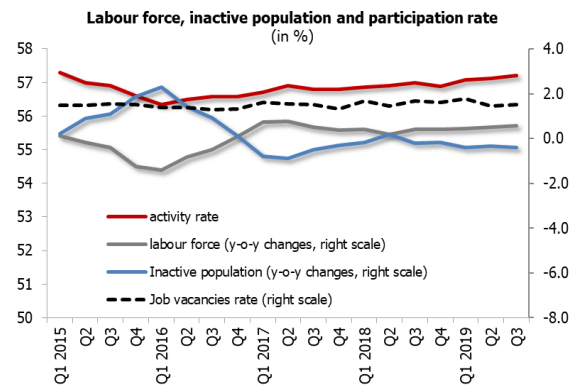


Source: State Statistical Office, Labour Force Survey.

In the third quarter of 2019, the employment rate amounted to 47.4%, which is an annual growth of 2.3 percentage points. Simultaneously, **the aggregated signals from business tendency surveys¹⁹ mainly suggest increased optimism** among managers of enterprises regarding the number of employees for the next three months. In the third quarter **the job vacancy rate²⁰ equals 1.5%** (1.7% in the same period of 2018). Analyzed on a longer-term basis, the job vacancy rate is relatively stable, which, amid continuous decrease in the unemployment rate, points to possible improvement of the connection process of the supply with the demand for skills in the labor market. Observed by activity, the highest job vacancy rate was registered in administrative and auxiliary services (3.4%), accommodation facilities and catering services (3.2%), as well as in real estate services (3.2%).



* In other services are included the activities from J+K+L+M+N+O+P+Q+R+S
Source: State Statistical Office



Source: State Statistical Office.

As for the movements on the side of labor supply, the growth trend from the last quarter of 2016 continued in the third quarter of 2019. Thus in the third quarter, the total labor force increased by 0.6% annually, while the activity rate equaled 57.2%.

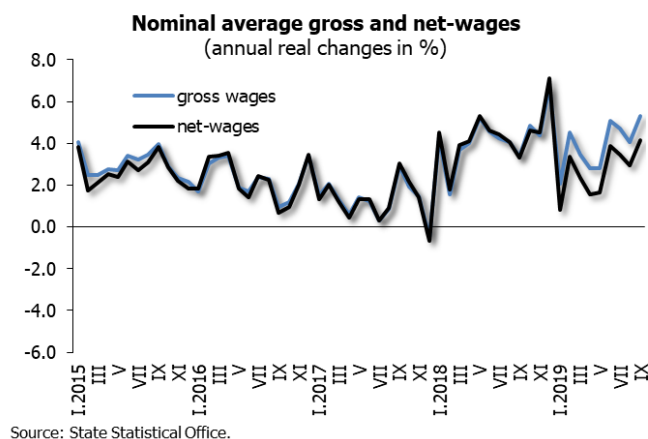
The stronger rise in the demand relative to supply of labor force in the third quarter of 2019 resulted in further fall in unemployment. The number of unemployed in the third quarter significantly decreased by 17.4% annually, while the unemployment rate reduced to 17.1% (annual and quarterly fall of 3.7 and 0.4 percentage points, respectively).

¹⁹ Source: State Statistical Office, business tendency surveys in manufacturing industry (October and November 2019), construction (third quarter of 2019) and trade (third quarter of 2019).

²⁰ The job vacancy rate is defined as the ratio between the number of job vacancies and the total number of jobs. Usually, the job vacancy rate is considered along with the unemployment rate (a relationship known as the Beveridge Curve). The placement of these two indicators gives information on labor market performance in terms of potential mismatches between demand profiles and those available on the job market at a given moment (skill mismatches). In particular, if both indicators are moving simultaneously, they are temporary, cyclical fluctuations, while in the case of the unemployment rate decreasing, with a stable vacancy rate, these are structural changes that is, improving the efficiency of the labor market.



The average net and gross wages paid in the third quarter registered an annual growth of 4.2% and 5.3%²¹, respectively, in part reflecting the annual adjustment of growth of the legally set minimum net wage²², as well as the second-round effect of the wage increase in some public sector segments²³. The highest annual net wage growth was recorded in the following activities: "health and social care", "transport and storage", "accommodation and food service activities", "administrative and auxiliary services" and manufacturing industry. In the third quarter, given the growth of consumer prices of 0,6%, **the real annual growth of net and gross wages was 3.5% and 4.7%, respectively.**



In terms of labor productivity, the annual decline observed in the first two quarters continued in the third quarter of 2019, but at a slower pace. In conditions of stronger employment growth than value added growth, labor productivity²⁴ decreased by 1.8% (decline of 2.8% in the previous quarter). In terms of sectors, the decline largely stems from lower productivity in the services sector. The continued increase in wages, amid a simultaneous decrease in productivity, contributed to a further increase in unit labor costs, which accounted for 7.1% in the third quarter (8.6% in the previous quarter). Therefore, most of the growth is explained with higher expenses in the

²¹ The faster increase in gross wages compared to net wages is a result of the increase in the rates at which contributions for compulsory pension and disability insurance and compulsory health insurance are paid, and due to the introduction of progressive personal income tax rates from early 2019. The rates at which contributions are paid in 2019 are 18.4% for compulsory pension and disability insurance and 7.4% for compulsory health insurance (previously these rates were 18% and 7.3%, respectively). The income tax, for the income acquired by labor, the income from self-employment, the income from copyrights and related rights and the income from the sale of own agricultural products, is paid at progressive rates, as follows: 10% personal income tax rate for income up to 90,000 denars (monthly tax base) and 18% on part of the income over 90,000 denars (previously applied proportional tax rate so-called "flat tax", which amounted to 10%).

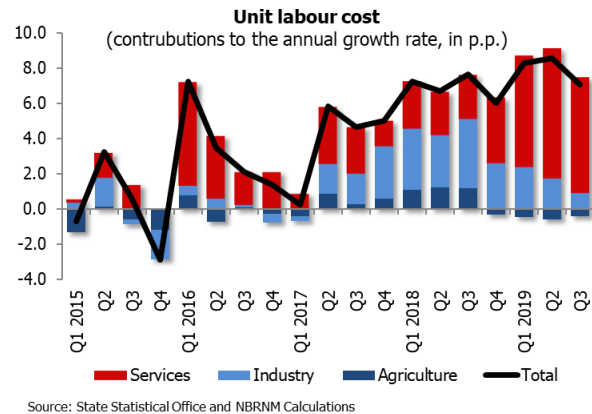
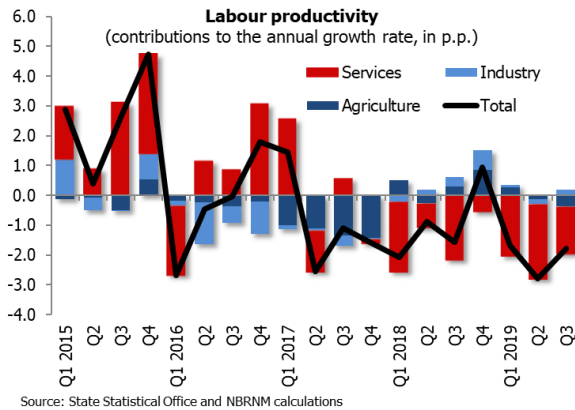
²² The amount of minimum wage according to the Law on Minimum Wage (Official Gazette of the Republic of North Macedonia No. 59/19) which is paid for the period from April 2019 to March 2020 is Denar 17,943 in gross amount, i.e. Denar 12,507 net wage (before this period, the minimum wage was Denar 17,370 gross and Denar 12,165 net) in accordance with the adjustment with the increase for the previous year of the average wage paid in the RNM, the consumer price index and the real GDP growth (with one third of the growth of each indicator, respectively).

²³ There was an increase in the wages of 5% for the employees in health, education and in kindergartens starting with the September wage in 2018. The RNM Budget for 2019 increased the wages of specialists by 10% from January and increased the wages by 5% of other medical personnel in the public health institutions with the payment of the January wage in 2019, and additionally increased the wages of health workers by 5%, starting with the payment of the September wage in 2019. Also, the Decision of the Government of the Republic of North Macedonia adopted in May 2019, leveled the wages of around 2,900 employees in the field of culture, national and local institutions, starting from the April wage for 2019. In addition, the amendments to the Law on Protection of Children, starting with the June wage, increase the wages of educators, carers/nurses, professional workers and associates by 16%, and the Labor Agreement increases the wages of ancillary-technical staff. The wages of social workers were also increased by 22% with the payment of the June wage, and with the payment of the September wage they also received an additional increase of 5%. In addition, there was 5% salary increase for employees in education, police, defense and the entire public sector, starting with the September wage.

²⁴ Total labor productivity is a weighted sum of productivity of each sector. Sector productivity is the ratio of the sector's value added to the number of employees.



services sector, amid slower growth in industry costs and a minimal reduction in costs registered in the "agriculture" sector.



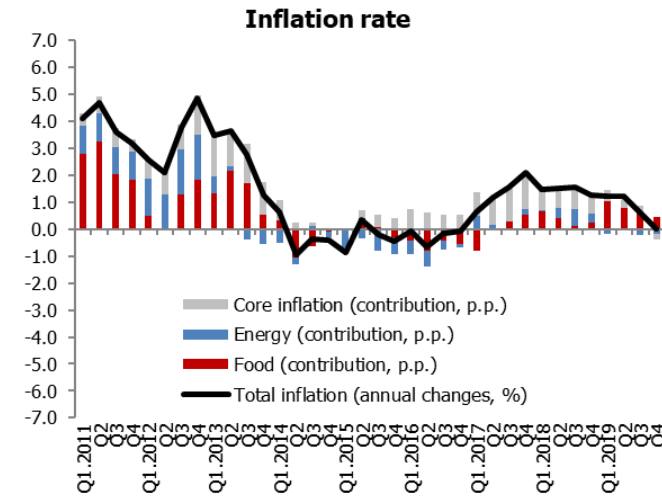
1.4 Inflation

In the fourth quarter of 2019, the annual growth of domestic prices continued to slow down. The annual inflation rate was reduced to 0%, compared to 0.6% in the previous quarter, with such a slowdown largely reflecting changes in core inflation. For the whole of 2019, the annual inflation rate is 0.8%, mainly driven by the growth of the food component, and to a lesser extent the positive contribution of core inflation. Regarding the future short-term dynamics of consumer prices, the current trends in imported inflation and domestic producer prices point to the absence of significant upward pressures. On the other hand, unit labor costs continued to rise in the third quarter, although at a moderate pace. In terms of expectations for the inflation rate in the coming period, according to the National Bank Survey, economic analysts expect the inflation rate in 2020 and 2021 to be 1.7% and 1.9%, respectively. Such expectations are similar to the National Bank forecasts, as well as the expectations of international institutions.

1.4.1 Current inflation

In the fourth quarter of 2019, the annual growth of consumer prices in the domestic economy continued to slow down to 0% (as opposed to 0.6% growth in the previous quarter)²⁵. The slowdown in the annual inflation rate is mainly a reflection of core inflation, which declined in the fourth quarter. Food prices also had an additional impact on slowing down the annual inflation rate. Energy prices registered slower decline on annual basis, in line with the movements of oil prices and oil derivatives on world markets. In terms of the structure of annual inflation in the last quarter, food prices increased, however, their positive annual contribution was completely offset by the decline in the energy and basic component.

²⁵ On a quarterly basis, consumer prices decreased by 0.4%, while on a seasonally adjusted basis they decreased by 0.3%.



Source: State statistical office and NBRNM calculations.

The core inflation rate registered a decrease in the fourth quarter and it equaled - 0.4% annually (0.6% in preceding quarter). The entry into the negative zone is largely a reflection of lower air traffic prices, with the fall in footwear prices, as well as the slower annual growth in tourism arrangements, having an additional impact. In terms of the structure of the annual decline in core inflation, the highest negative contribution is made by air traffic, followed by clothing, footwear and communication services prices. Other inflation sub-indices that exclude the most volatile prices are slowing down. Thus, the total index, excluding energy²⁶, liquid fuels and lubricants (for transport) and unprocessed food registered an annual growth of 0.6% (1.1% in the previous quarter), while the total index excluding energy, liquid fuels and lubricants (for transport), unprocessed food, tobacco and alcoholic beverages registered an annual growth of 0.3% (0.9% in the previous quarter).

	(annual changes, in %)										(contribution to annual changes, in p.p.)													
	2017				2018				2019				2017				2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Consumer price index - all items	1.4	1.5	1.5	1.6	1.2	1.5	1.2	1.2	0.6	0.0	0.8	1.4	1.5	1.5	1.6	1.2	1.5	1.2	1.2	0.6	0.0	0.8		
Food	0.0	1.7	1.0	0.2	0.6	0.9	2.7	2.1	1.5	1.2	1.9	0.0	0.7	0.4	0.1	0.2	0.3	1.0	0.8	0.6	0.4	0.7		
Energy	1.4	0.5	2.7	4.8	2.6	2.6	-1.4	-0.2	-1.7	-1.2	-1.1	0.2	0.1	0.4	0.7	0.4	0.4	-0.2	0.0	-0.2	-0.2	-0.2		
Electricity	-0.2	-0.2	-0.2	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Heat energy	-7.6	-2.5	-2.5	-2.8	-2.9	-2.7	-2.9	-2.9	-5.2	-6.4	-4.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Fuels and lubricants	6.7	2.0	11.1	19.6	10.7	10.7	-4.5	0.1	-5.1	-3.3	-3.2	0.2	0.1	0.4	0.6	0.4	0.4	-0.2	0.0	-0.2	-0.1	-0.1		
Food and energy (volatile prices)	0.4	1.4	1.5	1.5	1.1	1.4	1.6	1.5	0.6	0.5	1.0	0.2	0.7	0.8	0.8	0.6	0.7	0.8	0.8	0.3	0.3	0.5		
Core inflation calculated by the NBRM (total index - food and energy (categories 01.1, 04.5, 07.2.2))	2.3	1.6	1.5	1.7	1.3	1.5	0.9	1.0	0.6	-0.4	0.5	1.1	0.8	0.7	0.8	0.6	0.7	0.4	0.5	0.3	-0.2	0.2		
Overall index excluding energy, liquid fuels and lubricants and unprocessed food (SSO)	1.5	1.3	1.1	1.1	0.6	1.0	0.6	0.9	1.1	0.6	0.8													
Overall index excluding energy, liquid fuels and lubricants, unprocessed food, tobacco and alcoholic beverages (SSO)	1.2	1.0	0.7	0.9	0.3	0.7	0.3	0.5	0.9	0.3	0.5													

Source: State Statistical Office and NBRNM calculations.

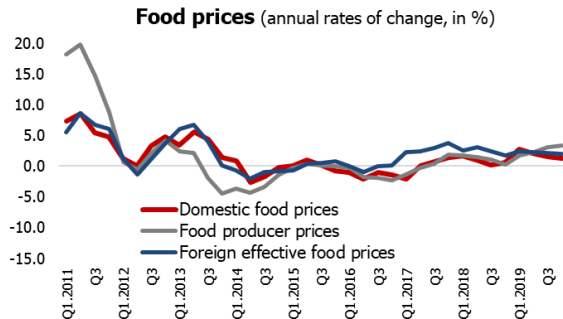
In the fourth quarter, the growth in food prices was more moderate (annual growth rate of 1.2% compared to 1.5% in the third quarter) and was mainly driven by the prices of bread and cereals, with the prices of meat, dairy products, fruits, as well as oils and fats having slight contribution. On the other hand, in the fourth quarter²⁷, the selling prices of the domestic food producers accelerated slightly, while the foreign effective food prices registered a growth similar to the one in the preceding quarter. **Energy prices** also experienced an annual decline in this quarter, which is slightly more moderate than the fall in the previous quarter, and the decrease was mainly explained by the movement

²⁶ The category "energy" refers to electricity, gas, liquid and solid fuels for heating and central heating.

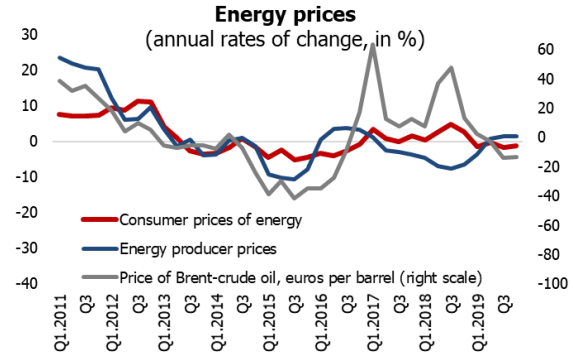
²⁷ The analysis of sales prices of domestic food producers and foreign effective food prices refers to the first two months of the fourth quarter.



of domestic prices of oil derivatives, and to a lesser extent, by the prices of central heating.²⁸ This shift in the domestic energy prices is in line with the moderate downward movement in the price of crude oil and oil derivatives on the world market. On the other hand, energy producer sales prices recorded a small annual increase²⁹ for the third consecutive quarter.



* Foreign effective food prices are calculated as weighted sum of food prices in countries that are major trade partners with North Macedonia.
Source: State statistical office, Eurostat and NBRNM calculations.



Source: State statistical office and NBRNM calculations.

Producer prices of industrial products registered moderate growth and slight growth slowdown in the fourth quarter (1.1% versus 1.2% in the third quarter), while producer prices **of energy and consumer goods registered minimal** acceleration (growth from 1.7% versus 1.5% in the third)³⁰. **The foreign effective inflation**³¹, as an indicator of imported inflation, in the fourth quarter registered moderate slowdown in the growth dynamics compared to the previous period (annual growth of 1.2% compared to growth of 1.3% in the third quarter). Despite the absence of significant pressures on domestic inflation so far through the channel of foreign prices and producer prices, **unit labor costs** continued to record high growth rates (7.1% in the third quarter, compared to 8.6% in the second quarter of 2019). Having in mind the small positive output gap³² in the domestic economy, the possible longer continuous growth in labor costs could potentially cause upward pressures on final product prices in the coming period.

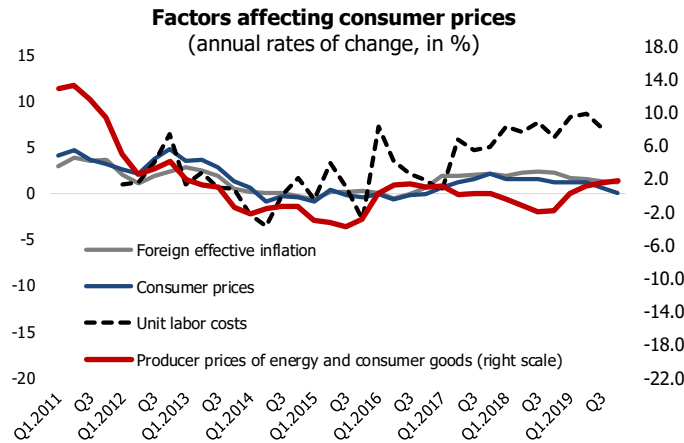
²⁸ According to the decision of the Energy Regulatory Commission, the price of central heating in the system of BEG as the largest supplier of heat in Skopje is reduced by 6% from August 2019, as a result of the previously adopted decision to reduce the VAT for heating energy from 18 to 5 %.

²⁹ Analysis of oil prices and sales prices of energy producers refers to the first two months of the fourth quarter.

³⁰ Producer price analysis of industrial products and producer prices of energy and consumer products for the fourth quarter refers to the first two months of the fourth quarter.

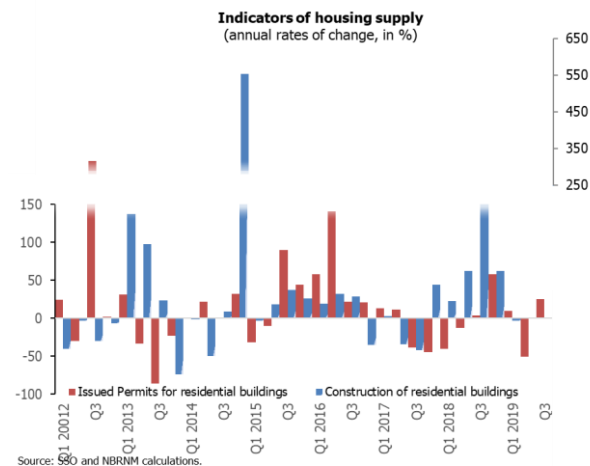
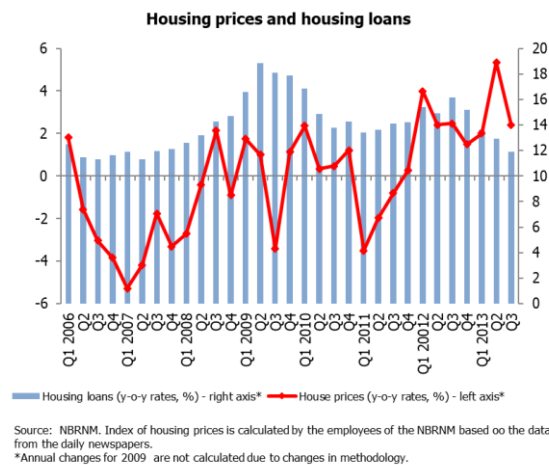
³¹ The calculation of foreign effective inflation derives from the weighted sum of consumer price indices of the countries that are major partners of the Republic of North Macedonia in the field of import of consumer goods. The weight structure is based on the normalized shares of nominal imports from each country in the total nominal imports in the period 2010-2012. The calculation of this indicator includes Bulgaria, Germany, Greece, France, Italy, Austria, Slovenia, Croatia and Serbia. The analysis refers to the first two months of the quarter.

³² The National Bank assessments show that domestic production is above the potential level (positive output gap) throughout the period of forecast (until 2020). However, it is estimated that the positive output gap throughout the period is small and stable.



Source: State statistical office and NBRNM calculations.

In the fourth quarter of the year, apartment prices, as measured by the Hedonic index³³, increase at a rate of 3.6% which is a moderate acceleration compared to the previous quarter. From the aspect of supply, the value of residential buildings declined in the third quarter of the year, while the value of issued building permits decreased as well³⁴. Regarding the demand,, in the fourth quarter of 2019, the demand for housing was underpinned by the growth of housing loans³⁵, although during 2019 there is a moderate slowdown in the growth dynamics.



1.4.2 Inflation expectations

Expectations for the next period do not indicate significant changes in terms of dynamics and inflation rate movements. Thus, according to economic analysts, a slight acceleration of the inflation rate is expected in the next two years. According to the **Survey of Inflation Expectations and Real**

³³ Hedonic index of housing prices, prepared by the National Bank on the basis of the notices of sale in the capital city, and published by the agencies dealing with trade in real estate. The apartment price is a function arising from the size of the apartment, the neighborhood in which it is located, the floor, whether the apartment has central heating and whether the apartment is new.

³⁴ The analysis refers to the first month of the fourth quarter.

³⁵ Available data for the first two months of the quarter.



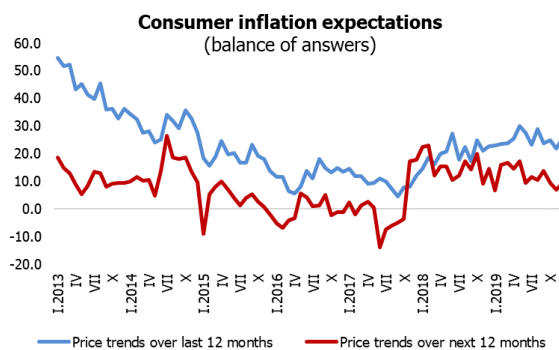
GDP Movement Survey³⁶ conducted in December, analysts expect that the inflation rate will accelerate to 1.7% and 1.9% in 2020 and 2021, respectively. Similar inflation movements and dynamics are envisaged by other domestic and international institutions.

Forecasts and expectations for the inflation rate

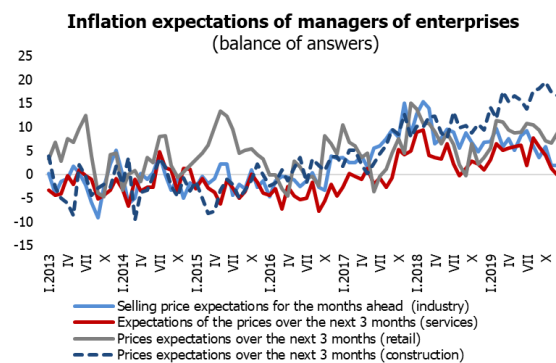
	2019	2020	2021
Economic analysts	1,2	1,7	1,9
IMF	1,3	1,7	2,0
Consensus Forecast	1,3	1,7	/
Ministry of Finance	1,0	1,7	2,0
NBRNM	1,0	1,5	2,0

Source: Inflation and real GDP growth expectations survey, December 2019; IMF World Economic Outlook, October 2019; Consensus Forecast, December 2019; Ministry of Finance, Fiscal strategy 2020-2022, December 2019; NBRNM, October 2019.

Short-term expectations of both the consumers and the managers of the companies regarding the price movements expressed in the fourth quarter surveys are similar. Thus according to the **“consumer expectations for price changes in the next 12 months”**³⁷, most people believe that prices will rise in the next 12 months, as opposed to the number of people expecting a reduction or unchanged prices. Expectations for increase in their prices in the next few months prevail also in the **corporate sector**³⁸. Expectations in trade and construction are more optimistic than in the previous quarter, while expectations in industry and services are more moderate.



Source: European Commission.



Source: European Commission.

1.5 Balance of payments

In the third quarter of 2019, the balance of payments' current account registered a surplus, a movement characteristic for this period of the year, although at a slightly lower level than the same period of the previous year. Such less favorable movements result from the deteriorated balance of foreign trade in goods and services, when primary and secondary income register no significant annual change. In the financial account, net outflows were realized during the third quarter, which mostly derive from the category of currencies and deposits, followed by portfolio investments and trade credits. At the same time, net inflows were generated by direct investments and borrowings from abroad. The total performance

³⁶ Starting from October 2017, the National Bank changed the current Inflation Expectations Survey. The new Survey on Inflation Expectations and Expectations for the Movement of the Real GDP is conducted on a sample of economic analysts, and the subject of the Survey has also been expanded, according to the practice of the European Central Bank (ECB).

³⁷ European Commission's Consumer Survey as of December 2019.

³⁸ European Commission's business tendency surveys in industry, retail trade, construction and services sector as of December 2019.

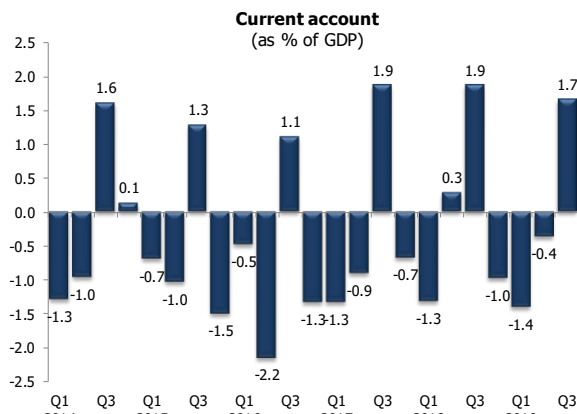


of individual balance of payments' components contributed to the increase in the foreign reserves in the third quarter of 2019.

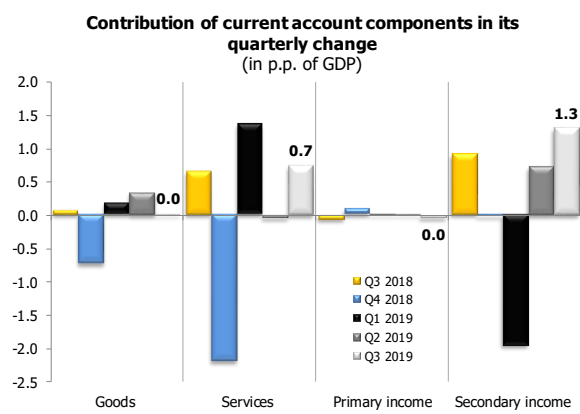
	2018				2019											
	Q1	Q2	Q3	I-IX	Q1	Q2	Q3	I-IX	Q1	Q2	Q3	I-IX	Q1	Q2	Q3	I-IX
I. Current account	-141.0	30.8	199.9	89.8	-156.2	-40.9	184.0	-13.1	-1.3	0.3	1.9	0.8	-1.4	-0.4	1.7	-0.1
Goods and services	-359.2	-285.6	-208.2	-853.0	-370.2	-337.3	-252.5	-960.0	-3.4	-2.7	-1.9	-8.0	-3.3	-3.0	-2.3	-8.6
Credit	1407.4	1566.2	1690.9	4664.4	1625.6	1706.6	1853.3	5185.5	13.2	14.6	15.8	43.6	14.6	15.3	16.7	46.6
Debit	1766.6	1851.8	1899.1	5517.4	1995.8	2043.9	2105.8	6145.5	16.5	17.3	17.8	51.6	17.9	18.4	18.9	55.3
Goods	-462.8	-403.1	-395.4	-1261.3	-472.9	-435.3	-432.5	-1340.8	-4.3	-3.8	-3.7	-11.8	-4.3	-3.9	-3.9	-12.1
Services	103.6	117.6	187.1	408.3	102.7	98.0	180.0	380.7	1.0	1.1	1.7	3.8	0.9	0.9	1.6	3.4
Primary income	-113.8	-111.3	-117.7	-342.8	-112.3	-111.1	-115.5	-339.0	-1.1	-1.0	-1.1	-3.2	-1.0	-1.0	-1.0	-3.0
Secondary income	332.0	427.7	525.8	1285.6	326.4	407.5	552.1	1286.0	3.1	4.0	4.9	12.0	2.9	3.7	5.0	11.6
II. Capital account	1.2	1.4	1.2	3.9	0.6	0.1	5.8	6.5	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Net lending (+) / net borrowing (-) (balance from current and capital account)	-139.7	32.3	201.1	93.6	-155.6	-40.8	189.8	-6.6	-1.3	0.3	1.9	0.9	-1.4	-0.4	1.7	-0.1
III. Financial account	-415.0	-16.7	112.7	-319.0	-149.2	-75.1	42.8	-181.5	-3.9	-0.2	1.1	-3.0	-1.3	-0.7	0.4	-1.6
Direct investment	-233.5	-69.7	3.8	-299.4	-40.2	-10.7	-62.4	-113.3	-2.2	-0.7	0.0	-2.8	-0.4	-0.1	-0.6	-1.0
Portfolio investment	-368.6	1.4	35.0	-332.2	22.3	19.8	72.2	114.3	-3.4	0.0	0.3	-3.1	0.2	0.2	0.6	1.0
Currency and deposits	80.0	73.1	72.8	225.8	35.2	-30.1	98.7	103.8	0.7	0.7	0.7	2.1	0.3	-0.3	0.9	0.9
Loans	47.9	-56.4	-35.3	-43.8	-17.8	-26.0	-54.3	-98.1	0.4	-0.5	-0.3	-0.4	-0.2	-0.2	-0.5	-0.9
Trade credit and advances	59.3	35.5	36.6	131.3	-148.8	-27.7	41.0	-135.5	0.6	0.3	0.3	1.2	-1.3	-0.2	0.4	-1.2
Other accounts receivable/payable	0.0	0.0	0.2	0.1	0.0	-0.3	-52.4	-52.7	0.0	0.0	0.0	0.0	0.0	0.0	-0.5	-0.5
Special drawing rights (Net incurrence of liabilities)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IV. Net errors and omissions	-18.6	12.0	3.2	-3.5	0.8	15.1	27.4	43.3	-0.2	0.1	0.0	0.0	0.0	0.1	0.2	0.4
V. Reserve assets	256.6	60.9	91.6	409.1	-5.6	49.4	174.4	218.2	2.4	0.6	0.9	3.8	0.0	0.4	1.6	2.0

Source: NBRNM.

1.5.1 Current account



Source: NBRNM.



Source: NBRNM.

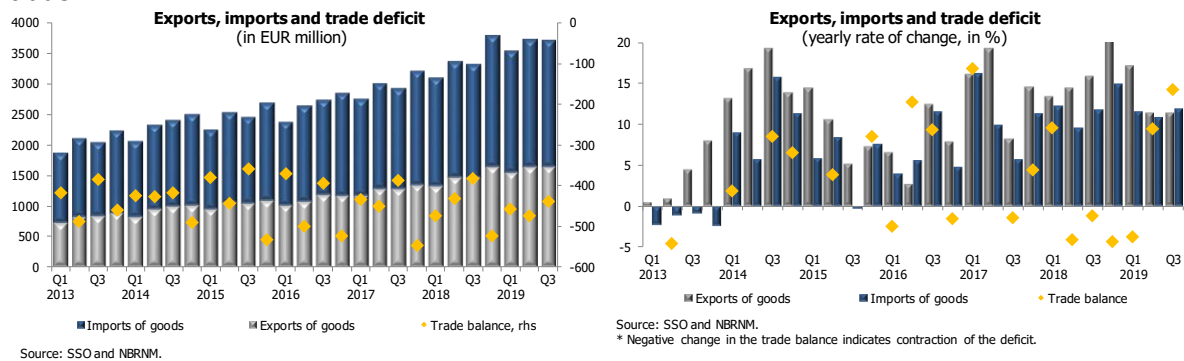
In the third quarter of 2019, the current account surplus was Euro 184 million or 1.7% of GDP³⁹, which is by 0.2 percentage points less compared to the same period of the previous year.

This change is largely due to the higher deficit in trade in goods and services. Namely, the higher deficit in the foreign trade of goods is entirely due to the increased non-energy balance, i.e. higher import of raw materials for some of the new production facilities in the economy. The lower positive balance in services category was mainly due to the less favorable performance of construction services (realized deficit compared to last year's surplus), as well as the lower surplus in transport services. The primary income deficit is slightly lower on an annual basis, while the secondary income surplus does not change significantly.

³⁹ The calculations use the projected amount of the nominal GDP (from October 2019).

**Annex: Foreign trade in goods and movement of the Nominal and the Real Effective Exchange Rate (NEER and REER)⁴⁰**

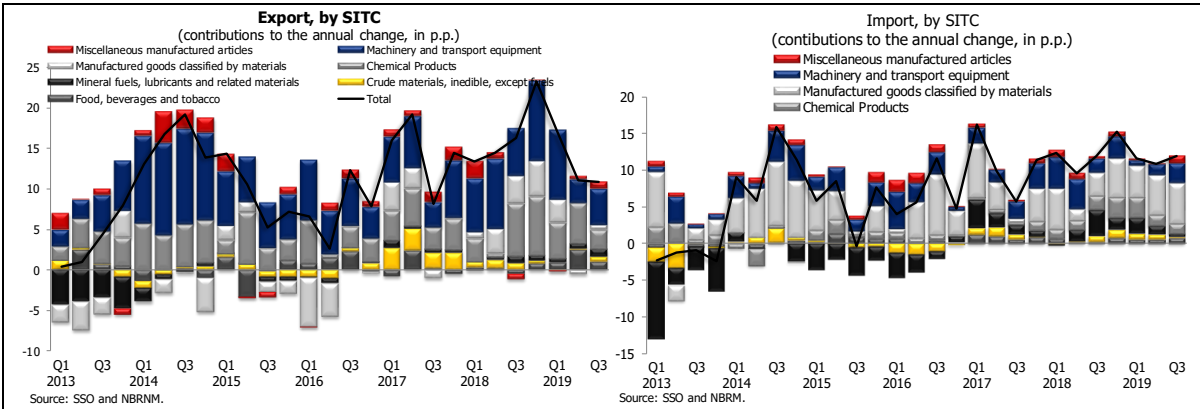
In the third quarter of 2019, foreign trade amounted to Euro 3,695 million, or 33.2% of GDP, which is an increase of 11.7% on annual basis, i.e. 2.4 percentage points of GDP. The solid growth of both export and import component contributes to the growth of total foreign trade.



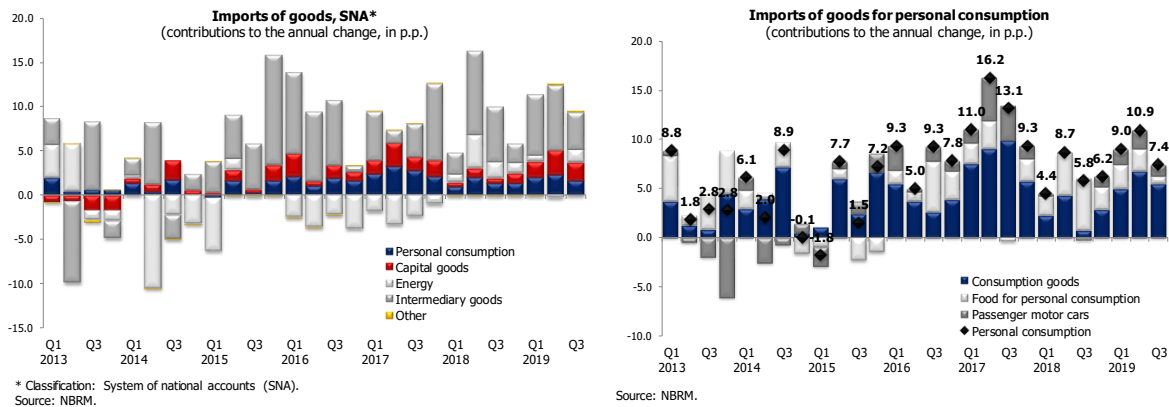
Export of goods in the third quarter of 2019 increased by 11.5% on annual basis, a dynamics similar to the previous quarter, when the annual growth was 11.3%. Favorable performance of new export-oriented facilities remain the dominant factor for export component growth, evident through higher export of machinery and transport equipment and to a lesser extent through growth in export of chemicals and furniture exports. Also some of the traditional export sectors registered an annual growth, such as food, ores and iron and steel, with higher energy exports also acting in the same direction. **In the third quarter, the import component also increased by 12%, which is growth intensification compared to the previous quarter when the annual change equaled 10.9%.** In line with export performance, higher imports of goods are driven by the raw material component of new export facilities, such as import of non-ferrous metals and machinery and transport equipment, as well as the category of chemicals and non-metallic mineral products. The increased import of non-ferrous metals and part of the higher import of non-metallic mineral products is due to the higher import prices, while the other two categories result from the higher imported quantities. In addition, higher import of food and iron and steel also contributed to the growth of imports. The energy component of imports again recorded positive growth rates, but its contribution to growth continued to decline in the third quarter, driven by favorable stock market prices of energy, given further growth in imported quantities. **Export and import movements in the third quarter contributed to further widening of the trade deficit by 14.3% on annual basis.** Analyzed by individual balances, the change was due exclusively to non-energy balances, in conditions when the energy deficit narrowed on annual basis.

The latest available data on foreign trade for October and November indicate a slight decline in export activity, amid a slight annual increase in the import component. More specifically, **the export of goods** in October and November 2019 is lower by 1.3% compared to the export in the same period of the previous year, a change largely driven by the performance of some of the new export facilities in the economy. The **import of goods** in these two months registered a slight annual growth of 1.7%, as a result of the higher ore imports, and to a lesser extent the higher energy imports and import of equipment and machinery.

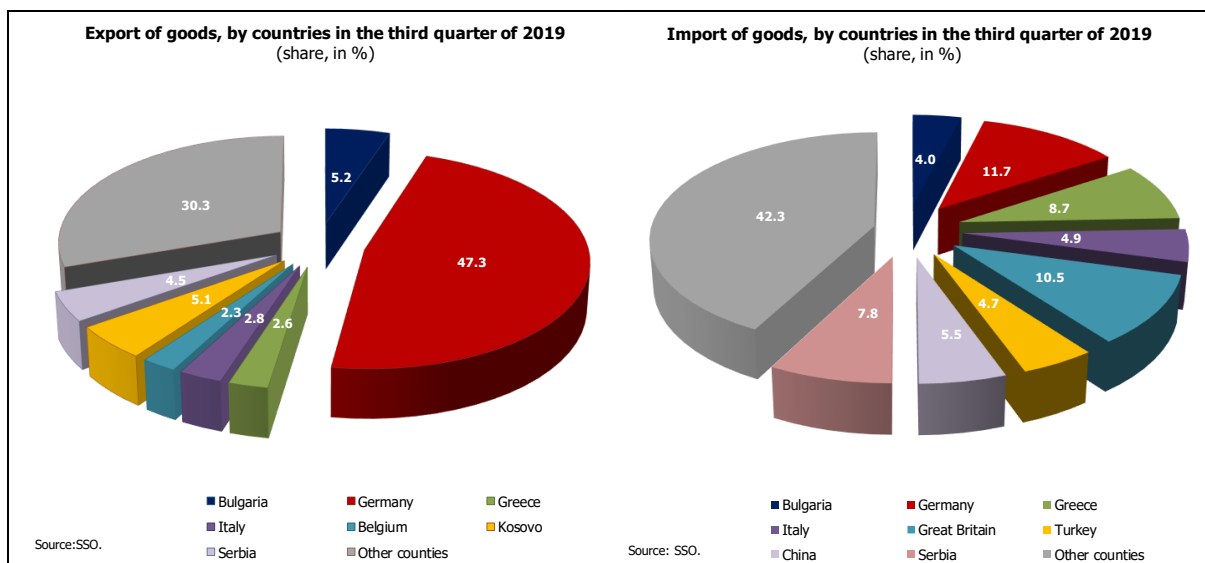
⁴⁰ According to the Foreign Trade Methodology, data on the export of goods are published on an f.o.b. basis, and on the import of goods, on a c.i.f. basis.



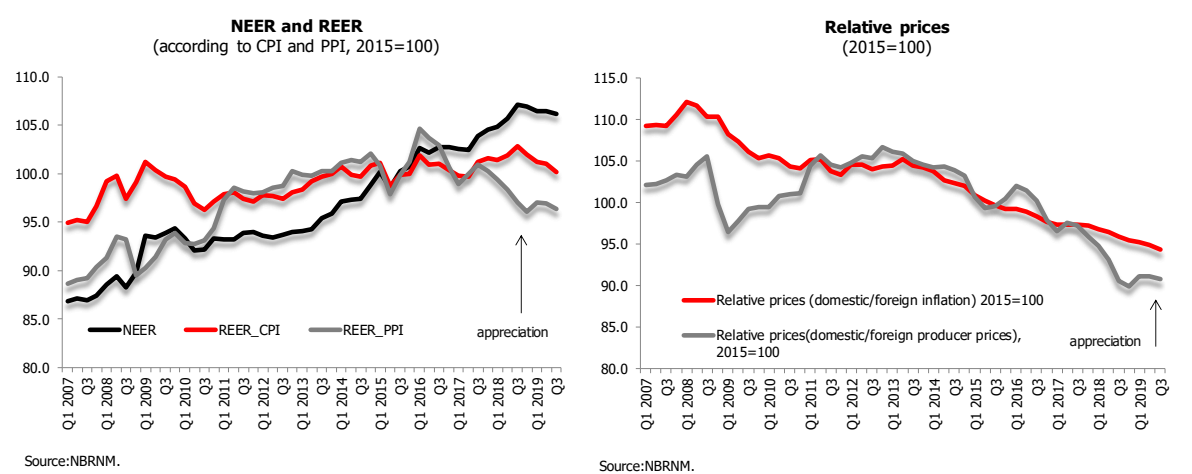
According to the analysis of the import of goods by the division set in the System of National Accounts – SNA), the import growth in the third quarter was largely driven by import of intermediate products, while the positive contribution of other constituents to overall growth was more moderate. In terms of imports for private consumption, the annual growth of this component reflects the higher import of consumer goods and food, amid moderate contribution by the import of passenger vehicles. Analyzed dynamically, the growth of imports for personal consumption in the third quarter of 2019 does not indicate significant pressures on the total imports.



The analysis of foreign trade by trading partners in the third quarter of 2019 confirms the dominance of the European Union in the foreign trade of the domestic economy. As the most important trading partner, the EU accounted for 69.7% of total foreign trade. On the export side, the driver of the annual growth was the higher export of equipment and machinery and products of the chemical industry to Germany, due to increased foreign facilities' exports to the largest European economy. Increased export of iron and steel to China, as well as increased export of energy, food and beverages to Kosovo, contributed to the growth, as well. Higher energy exports have also been made to Serbia. The analysis of imports by trading partners indicates that growth is largely driven by the import of precious metals from the UK, followed by imports from Germany, dispersed across several categories, including vehicles and equipment and machinery. In addition, higher import of equipment and machinery from Serbia also contributed to the of import growth. Analyzed in terms of balances, the widening of the trade deficit in the third quarter is a reflection of the trade performance with the EU countries, where the balance was steady, as opposed to the surplus in the third quarter of 2018. The deteriorated position in the trade with our most important trading partner is due in large part to the higher trade deficit with the UK, but also to the trade balance with Belgium and Austria, where the small surplus realized in the same period of the previous year turned into a deficit. At the same time, the trade surplus with Germany continued to record positive annual rates of change. In addition, the trade dynamics with Kosovo and China has also been positive, where surplus and deficit reduction have been observed, respectively, in foreign trade with these countries.



Price competitiveness indicators of the Macedonian economy registered favorable movements in the third quarter compared to the same period last year. The CPI-deflated REER depreciated annually by 2.6%, while the PPI-deflated REER depreciated by 0.6%. In terms of relative prices, relative consumer prices registered annual decrease (of 1.6%), while the relative producer prices registered a slight increase (of 0.3%). The NEER index depreciated by 1% compared to the same period last year, due to the appreciation of the Russian ruble and the Ukrainian hryvnia against the denar.

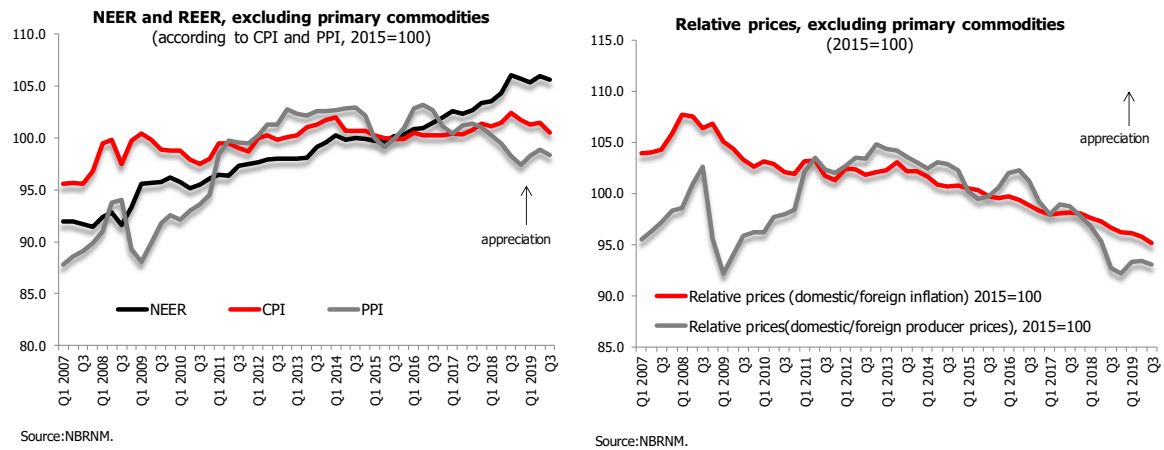


The analysis of REER indices, as measured by foreign trade weights without primary commodities⁴¹ generally points to similar conclusions. Namely, REER deflated by consumer prices depreciated by 1.9% on annual basis, while REER calculated by producer prices did not change compared to the same period of the previous year. The NEER index depreciated by 0.4% on annual basis, while the relative prices registered divergent movements and the relative consumer prices declined (by 1.5%), while the relative prices of industrial products registered a slight annual increase (of 0.4%).

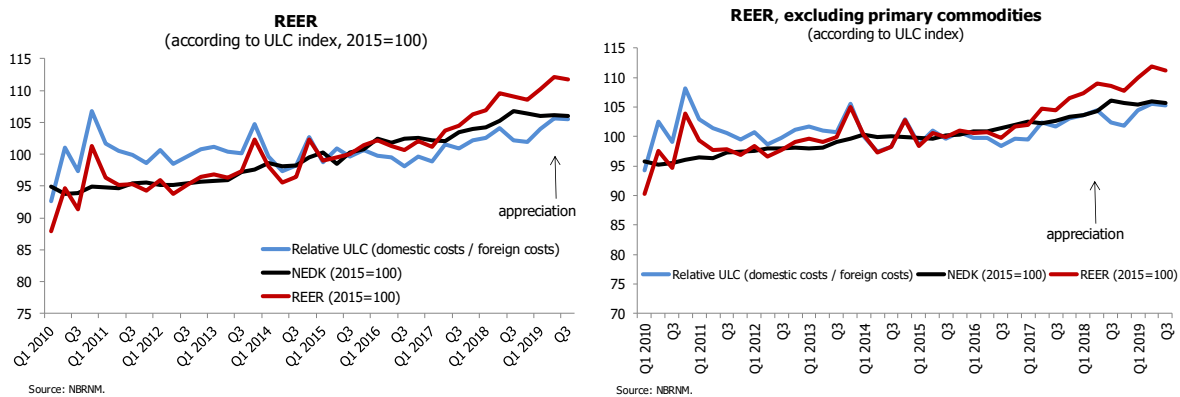
⁴¹ Primary products not included in the calculation are: oil and oil derivatives, iron and steel, ores and imported raw materials for the new industrial facilities. For more detailed information on the methodology for calculating the real effective exchange rate visit: http://nbrm.mk/WBStorage/Files/Statistika_REDK_Informacija_za_promenite_na_metodologijata_za_presmetuvanje_na_realno_t_efektiven_devizen_kurs_na_denarot_mak.pdf



The latest data on price competitiveness for October and November 2019 indicate divergent movements in the index calculated by total foreign trade weights. The CPI-deflated REER depreciated by 3% annually, while the PPI-deflated REER appreciated by 0.6%. Divergent movements were also registered in the index calculated by weights based on foreign trade statistics, especially depreciation of the index deflated by consumer prices of 2.1% on annual basis and appreciation in REER calculated by producer prices of 1.1%.



In the third quarter of 2019, the analysis of REER indices calculated by unit labor costs indicates moderate deterioration of price competitiveness of the domestic economy. The REER index calculated by weights based on total foreign trade appreciated by 2.5%. The relative labor costs registered an annual growth of 3.3%, while the NEER depreciated by 0.7%. Annual appreciation was registered in the REER index calculated by using weights based on the foreign trade without primary commodities at the same pace of 2.5%, determined by the growth of the relative labor costs (of 2.9%) amid depreciation of the NEER (of 0.4%).



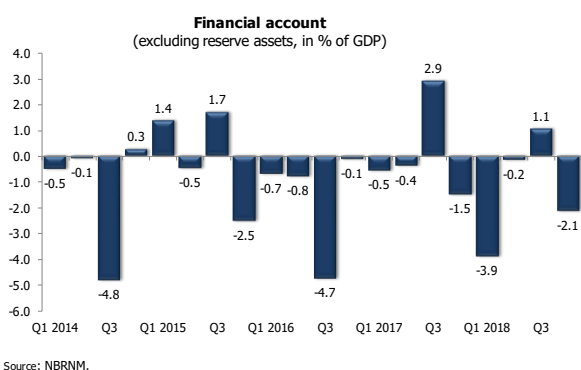
1.5.2 Financial account

The financial account in the balance of payments recorded net outflows of Euro 42.8 million in the third quarter of 2019, or 0.4% of GDP. Net outflows were recorded in the categories of currency and deposits, portfolio investments and trade credits, which were partially neutralized by net inflows based on direct investments, loans and other collection accounts.⁴² Unlike the second quarter of 2019, in the third quarter, currencies and deposits remained the most significant outflow category,

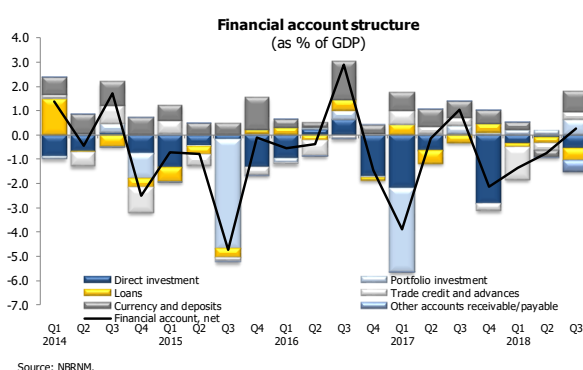
⁴² Inflows related to changes in the ownership structure in the banking system.



reflecting the negative flows with other sectors of the economy, as well as with depository corporations. Additional adverse impact on the position of the financial account is caused by portfolio investment outflows and private sector disbursement through further repayment of accumulated commercial loans. On the other hand, the foreign direct investment and the moderate net inflows based on financial loans contributed towards mitigation of negative flows in the financial account. Concerning direct investments, the positive developments are the result of the net inflows on equity and intercompany debt. The positive developments in lending largely reflect the borrowing of other sectors and depository corporations in the form of long-term loans, and to a lesser extent, the increase in short-term liabilities of depository corporations abroad.



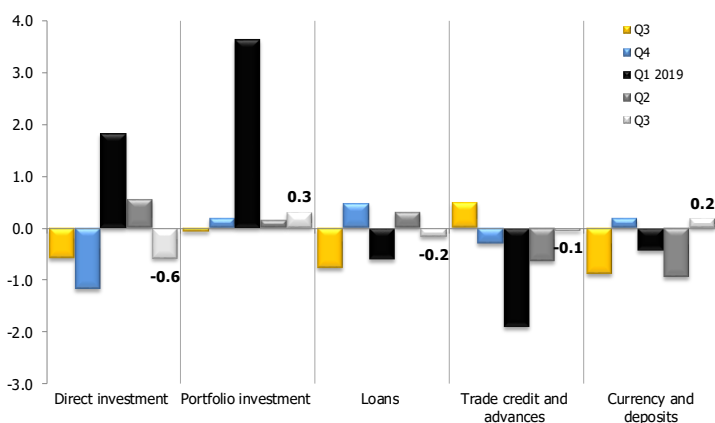
Source: NBRNM.



Source: NBRNM.

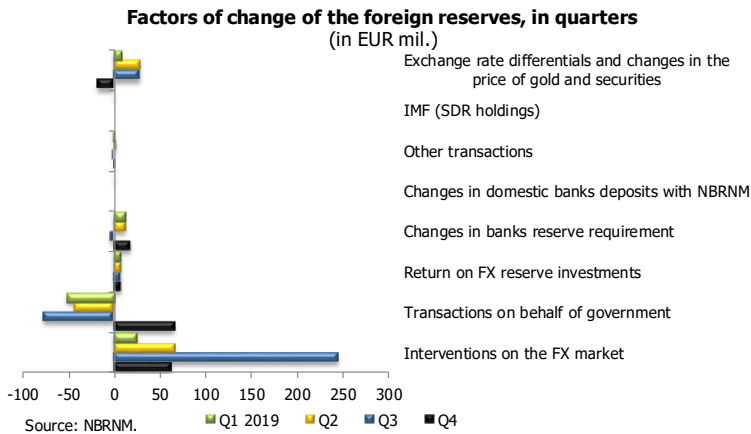
The annual analysis points to lower net outflows in the financial account. Thus, more favorable annual movements are the direct investments and the financial loans. Foreign direct investments registered net inflows compared to the neutral flows in the same period last year, while the inflows on the basis of loans were higher than in the analyzed period of the previous year. On the other hand, slightly higher net outflows were registered in portfolio investments, currencies and deposits and trade credits.

Contributions to the annual change in the financial account (in p.p. of GDP)

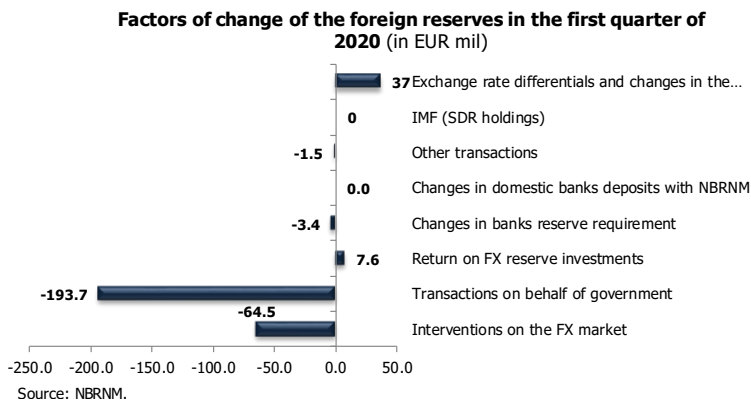


Source: NBRNM.

At the end of the third quarter of 2019, the gross foreign reserves amounted to Euro 3,127.5 million, which is a quarterly growth of Euro 199.3 million. The increase in the foreign reserves is mainly driven by the National Bank interventions by purchasing foreign currency during the third quarter. On the other hand, transactions for the account of the government reduced the foreign reserves. The remaining categories had a moderate impact on the increase in foreign reserves in this period.



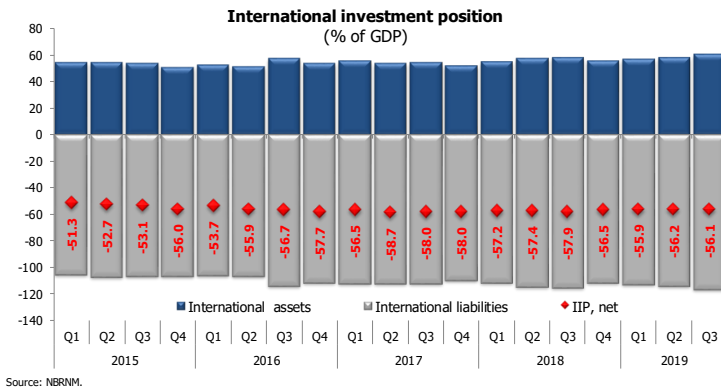
As of 31.12.2019, the gross foreign reserves stood at Euro 3,262.6 million, up by Euro 395.5 million compared to the end of 2018. The National Bank interventions on the foreign exchange market significantly increased the foreign reserves, while the transactions on behalf of the government reduced the foreign reserves. The other flows registered no major changes.



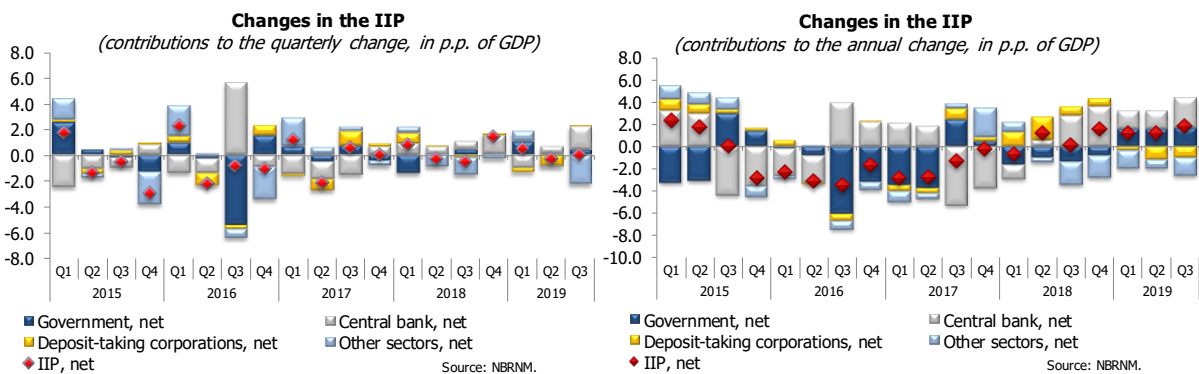
1.5.3 International investment position and gross external debt

The international investment position of the Macedonian economy at the end of the third quarter of 2019 was negative and equaled Euro 6,238.3 million, or 56.1% of GDP⁴³. Compared to the same period last year, negative international investment slightly improved by 0.1 percentage point of GDP, in conditions of higher growth of international assets compared to growth of international liabilities. By sector, the quarterly improvement is mainly due to the higher net assets of the central bank (due to the increase in foreign reserves), and then to the lower net liabilities of the government and the banking sector. On the other hand, higher net liabilities were recorded in other sectors of the economy, primarily due to higher net liabilities based on trade credits and long-term loans.

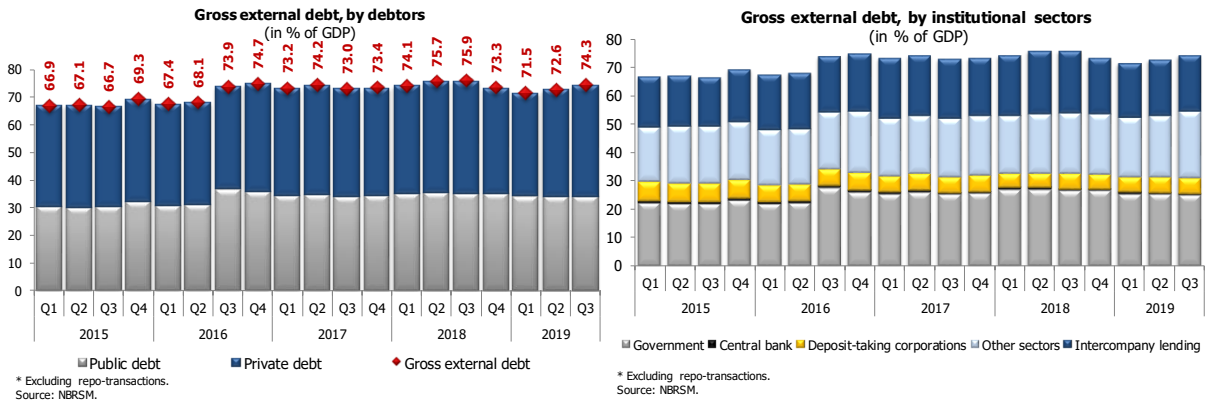
⁴³ The calculations use the projected amount of the nominal GDP (from October 2019).



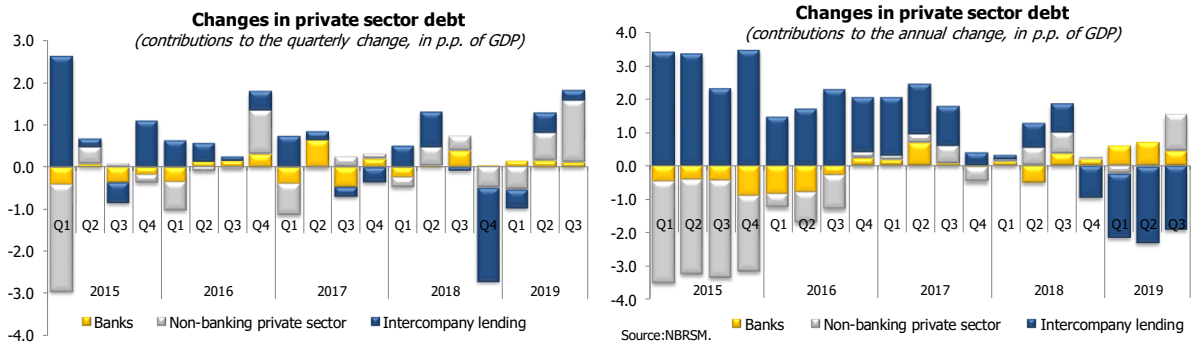
The annual change in the international investment position also indicates an improvement of 1.8 percentage points of GDP, amid higher growth of international assets relative to growth of international liabilities (by 2.8 percentage points and 0.9 percentage points of GDP, respectively). In terms of sectors, such a change results from the favorable shifts in the net position of the central bank (due to the increase in foreign reserves) and the Government (mainly reflecting lower liabilities based on debt securities and loans). These movements were partially neutralized by the shifts in the net position of other sectors (increased net liabilities based on direct investments, trade credits and long-term loans) and the net position of depository corporations (lower net assets in currencies and deposits).



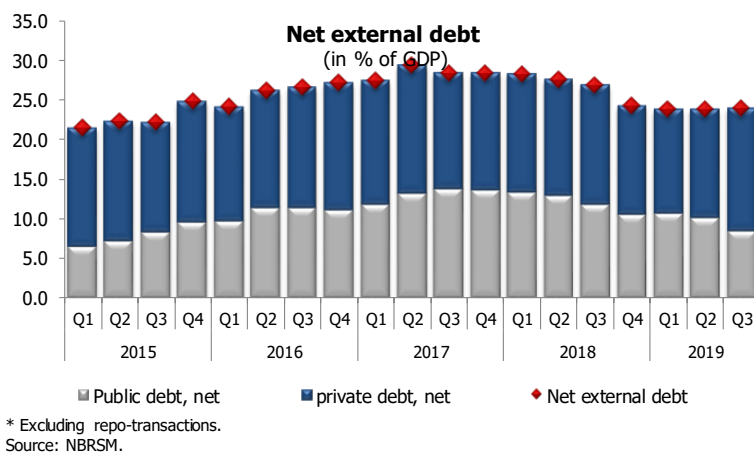
At the end of the third quarter of 2019, the gross external debt equaled Euro 8,575.3 million, or 77.1% of GDP, which is a quarterly increase of 2.2 percentage points of GDP. Excluding the effect of the National Bank repo transactions, the gross external debt equals 74.3% of GDP and is higher by 1.7 percentage points of GDP, compared to the previous quarter, which is entirely due to the higher private sector debt, amid slight quarterly reduction in public sector debt. The quarterly growth of private sector debt is mainly a reflection of the higher debt of the non-banking private sector, in the form of trade credits and other liabilities, then of the increased intercompany debt, as well as of the higher liabilities of the banking sector. Regarding the public debt, the change was mostly due to the lower government liabilities on long-term debt securities.



On an annual basis, the gross external debt decreased by 1.6 percentage points of GDP, given the fall in both public and private debt (of 1.1 and 0.4 percentage points of GDP, respectively). The decrease in public sector debt is largely due to lower government liabilities based on debt securities and loans, while higher liabilities based on long-term loans to public enterprises acted in the opposite direction. At the same time, the annual decrease in private debt is largely due to the decline in intercompany lending.



As of 30.9.2019, the net external debt stood at Euro 2,668.8 million, or 24% of GDP, which is a small quarterly increase of 0.1 percentage points of GDP. The higher net external debt is mainly due to the higher net debt of the private sector (by 1.8 percentage points of the GDP), given fall in the public net debt (of 1.7 percentage points of the GDP).



External indebtedness indicators of the national economy remain in the safe zone. Gross external debt to GDP ratio still classifies our economy in the group of highly indebted countries, while



all other ratios point to low indebtedness. However, the analysis by the dynamics indicates favorable developments in most of solvency and liquidity indicators.

Indicators for external indebtedness	Solvency				Liquidity		
	Interest payments/ Export of goods and services and other inflows	Gross debt/ Export of goods and services and other inflows	Gross debt/ GDP	Debt servicing/ Export of goods and services and other inflows	Foreign reserves/ Short-term debt	Foreign reserves/ Short-term debt, with residual maturity**	Short-term debt/ Overall debt
	in %				ratio	ratio	in %
31.12.2010	3.22	140.4	59.7	13.9	1.49	0.99	27.9
31.12.2011	3.12	148.4	64.6	16.8	1.78	1.18	25.2
31.12.2012	2.92	142.1	67.6	13.1	1.64	1.03	26.7
31.12.2013	2.51	137.3	67.3	15.8	1.64	1.08	23.3
31.12.2014	3.01	149.1	74.0	17.2	1.82	1.13	22.3
31.12.2015	2.69	143.9	73.2	20.0	1.69	1.13	21.3
31.12.2016	2.37	149.39	79.33	14.89	1.65	1.16	21.93
31.03.2017	2.69	138.68	76.61	12.72	1.47	1.00	23.53
30.06.2017	2.69	140.69	77.72	12.72	1.33	0.88	24.19
30.09.2017	2.69	138.24	76.37	12.72	1.26	0.86	24.57
31.12.2017	2.69	139.17	76.88	12.72	1.32	0.89	23.94
31.03.2018	2.22	132.80	78.27	15.77	1.30	0.93	25.06
30.06.2018	2.22	135.55	79.89	15.77	1.27	0.96	25.61
30.09.2018	2.22	135.98	80.14	15.77	1.30	0.98	25.59
31.12.2018	2.22	131.37	77.42	15.77	1.42	1.04	25.75
31.03.2019	2.39	118.71	74.90	10.78	1.39	0.98	25.85
30.06.2019	2.39	120.59	76.08	10.78	1.37	0.97	26.37
30.09.2019	2.39	123.40	77.85	10.78	1.37	0.97	27.61
Moderate indebtedness criterion*	12 - 20%	165 - 275%	30 - 50%	18 - 30%	1.00		

*The moderate indebtedness criterion is according to the World bank's methodology of calculating indebtedness indicators, which implies 3-year moving averages of GDP and exports of goods and services in the calculation of the indicators.

In compliance with "External debt statistics: Guide for compilers and users," published by the IMF.

*According

to the "Greenspan-Guidotti rule", a country should maintain full coverage of short-term debt at remaining maturity with gross foreign reserves.

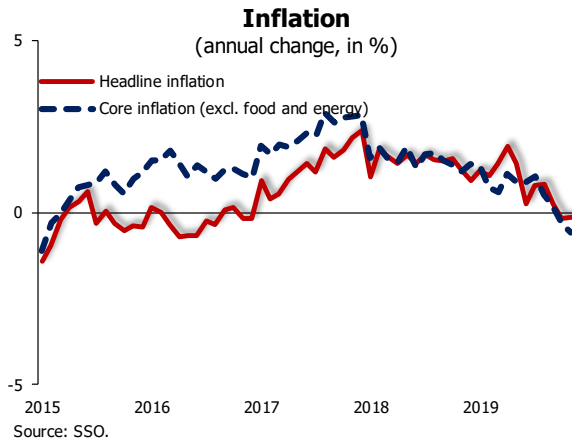
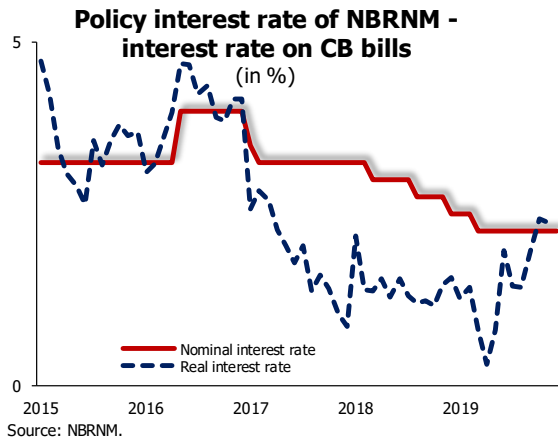
Short-term debt at remaining maturity is calculated by addition of the long-term external debt (original maturity), with final contractually scheduled payment of less than a year, to the short-term debt (original maturity).

Source: NBRNM.

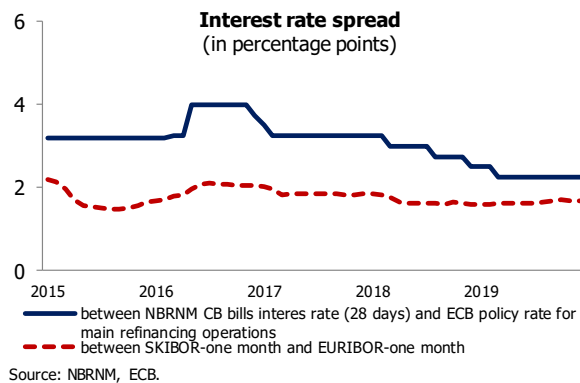
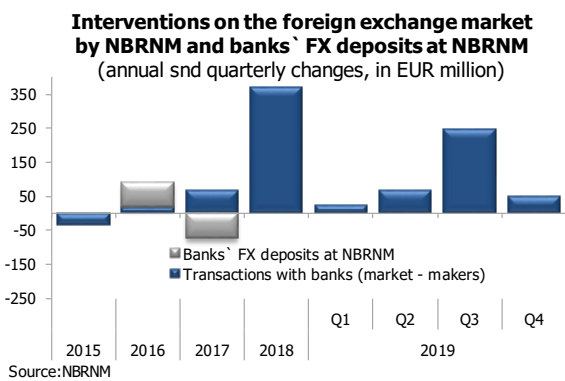
II. Monetary policy

In the fourth quarter of the year, the National Bank did not change the monetary policy position, and the policy rate remained at the level of 2.25%. In conditions of further assessments of sound economic fundamentals and the absence of imbalances in the economy, foreign exchange market movements remained favorable. In the fourth quarter of the year, the foreign reserves increased, and according to all adequacy ratios, they are still maintained in the safe zone. Total deposits and total loans continued to mount on an annual basis. The dynamics and currency structure of household savings show stable expectations. The latest data does not indicate major deviations from the forecasts in the key monetary policy segments. The National Bank will continue to carefully monitor the trends and potential risks of the domestic and external environment, in order to adequately adjust the monetary policy setup.

During the fourth quarter of 2019, the National Bank policy rate - CB bill interest rate remained 2.25%. The regular review of the monetary setup showed that the monetary setup was appropriate to the current economic and financial conditions and that the economic fundamentals remained sound, without any imbalance. The low and stable inflation and favorable position of the balance of payments from the beginning of the year continuously contribute to favorable movements on the foreign exchange market and purchase of foreign currency by the National Bank. The dynamics and currency structure of household savings show stable expectations and favorable perceptions.



The performances with the basic macroeconomic indicators in the domestic economy were mainly within the projected dynamics with the October projections cycle. Regarding inflation, in the period October - November, consumer prices declined annually (by 0.2% on average), bringing the cumulative rate to 0.8%, slightly below the expected inflation of 1%. 2019. The uncertainty about the movements of primary commodities prices on the world markets was assessed to be the main risk factor for the forecast of domestic inflation for the coming period. In terms of economic activity, the estimated GDP data show that in the first three quarters of the year, GDP increased by 3.6%, which is in line with that forecasts for this period of the year. Regarding the state of the economy in the fourth quarter, the available high frequency indicators pointed to further intensification in the economic activity. Foreign reserves increased in the fourth quarter, mainly due to foreign exchange inflows, on a net basis, resulting from government transactions⁴⁴, as well as from the National Bank's purchase of foreign currency on the foreign exchange market. Foreign reserves adequacy ratios have shown that their level is appropriate and maintained in the safe zone. Analyzing the movements in total deposits and total loans, the available November data show their further annual growth, while the previous movements do not indicate larger deviations from the forecast.



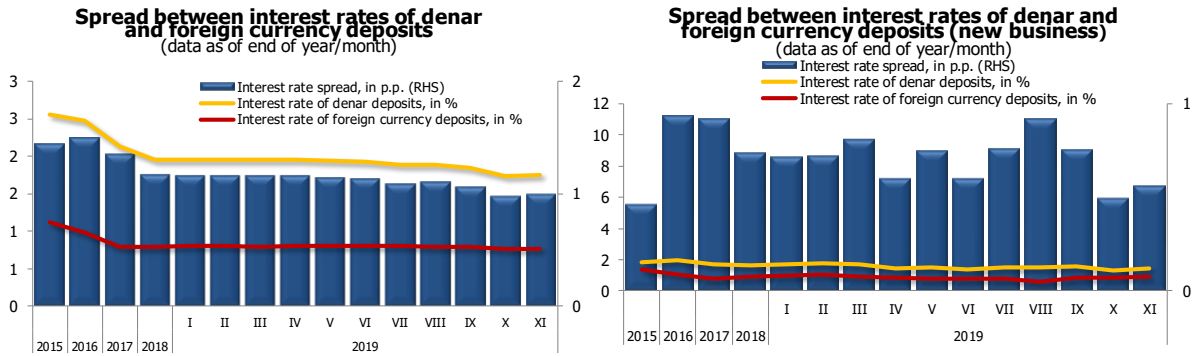
Concerning the external environment, downward risks to projected global economic growth were also present in the fourth quarter, with central banks globally still pursuing easy monetary policies, with the ECB reactivating the quantitative easing program. Given the unchanged key interest rate of the National Bank and the ECB interest rate⁴⁵ in the fourth quarter of 2019, the spread between these interest rates remained at the same level as in the previous two quarters. Regarding the indicative market rates, compared to September, no changes were noticed in the one-month EURIBOR and one-month SKIBOR, keeping their interest spread stable.

⁴⁴ Mostly as a result of the government's borrowing from the World Bank a loan of Euro 125 million, intended for the implementation of development policies for public finance and competitiveness.

⁴⁵ Interest rate on main refinancing operations.

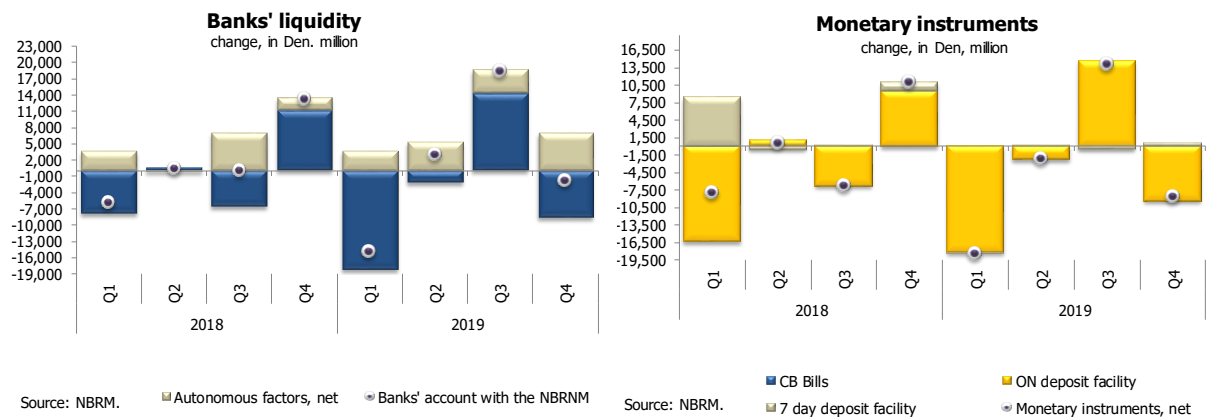


In the domestic economy, with the total interest rates, there was slight decrease in the interest rate on denar deposits by 0.1 percentage point compared to September, given the interest rates on the foreign currency deposits. As a result, the interest rate spread slightly narrowed from 1.1 to 1.0 percentage point. With the newly accepted deposits, interest rate on denar deposits decreased by 0.1 percentage point, amid increase in the interest rate on foreign currency deposits by 0.1 percentage point, which led to narrowing of their interest rate spread from 0.8 percentage points to 0.6 percentage points.



2.1 Bank liquidity

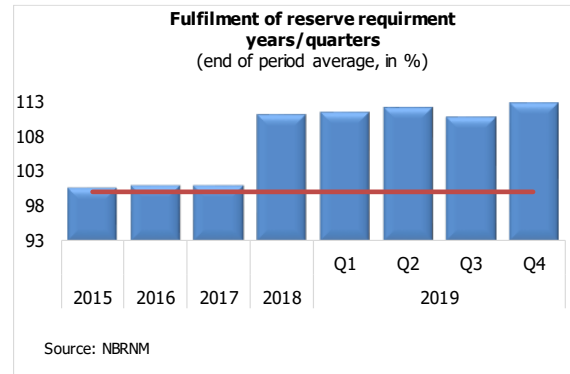
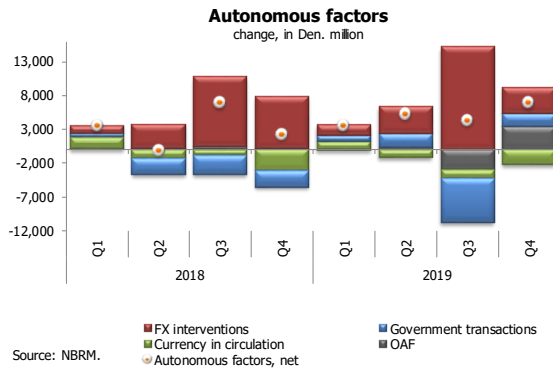
In the fourth quarter of 2019, the banks' denar liquidity declined, which was mainly due to the change in the monetary instruments, primarily the short-term banks' deposits with the National Bank. Autonomous factors, net, acted towards creating net liquidity in the banking system.



The banks' deposit facilities with the National Bank increased (by Denar 8,928 million), which is entirely due to the growth of overnight deposits, while the stock of the 7-day deposits minimally decreased. As of the end of the fourth quarter, the stock of the main instrument, the CB bills, amounted to Denar 24,769 million and was slightly lower compared to the end of the third quarter (Denar 25,000 million)⁴⁶.

The autonomous factors, on a net basis in the fourth quarter, contributed towards liquidity creation in the amount of Denar 6,922 million. This change is mainly a result of the National Bank interventions on the foreign exchange market with purchase of foreign currency, as well as on the government transactions, while the currency in circulation acted toward liquidity withdrawal from the banking system.

⁴⁶ During the quarter, three CB bills auctions were held, offering CB bills in the amount of Denar 25,000 million at an interest rate of 2.25%.



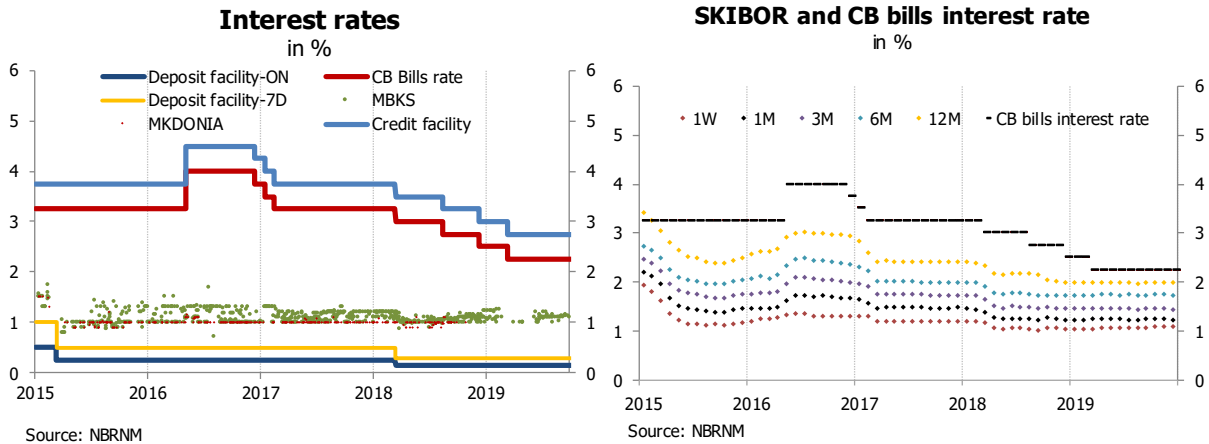
Observed by reserve requirement, in the fourth quarter of the year, the banks had more funds allocated to the National Bank accounts than the required amount of reserve requirement in denars, on average by 12%.

III. Financial market developments

In the fourth quarter of 2019, the interbank interest rate on the deposit market remained low and stable. In the absence of a change in the key interest rate of the National Bank, no changes were observed in the indicative interest rates on interbank deposit trading (SKIBOR). At the primary market of government securities, the new issues were in longer terms and in domestic currency, while in the secondary market, government bonds were traded. Macedonian Eurobond yields continued to decline, narrowing the spreads relative to yields on German government bonds, which registered an uptrend. On the Macedonian Stock Exchange, MBI-10 continued increasing, same as most stock markets in the region. In the international financial markets, the indices for volatility of financial conditions have moved downwards, indicating lower uncertainty on the markets.

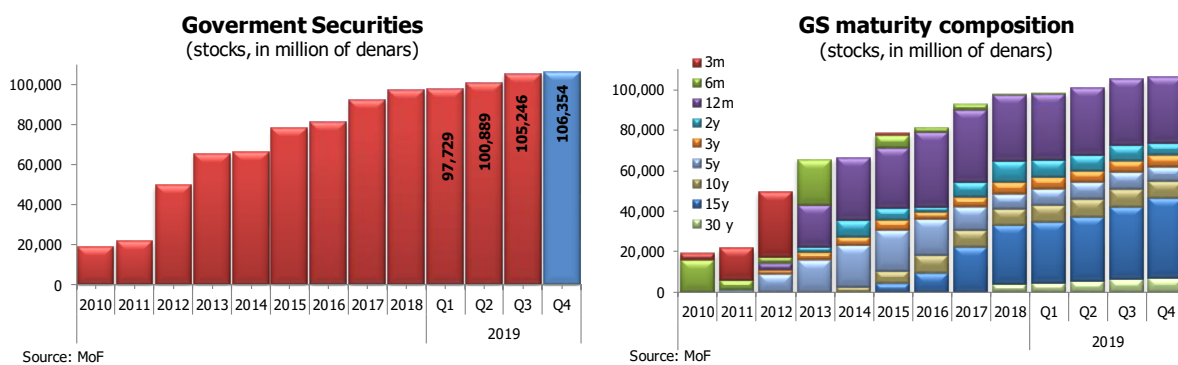
3.1 Interbank market for uncollateralized deposits

The interest rate on the interbank deposit market in the fourth quarter equaled 1.2% and remained at a low and relatively stable level (1.1% in the third quarter). The minimal upward movement in the interbank interest rate arises from the participation of transactions with 1-day maturity in the total turnover on the interbank deposit market (interbank transactions with deposits with maturity of up to 7 days and up to 1 month). In conditions of unchanged key interest rate of the National Bank, no changes in the SKIBOR quotations were registered.



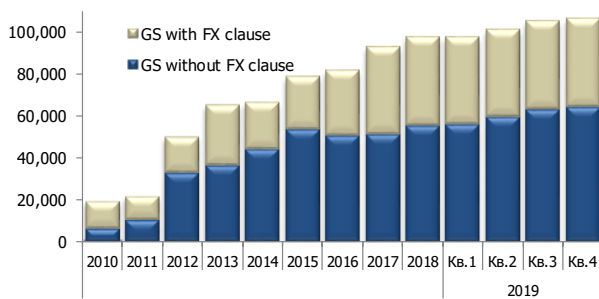
3.2 Government securities market

The stock of government securities also grew in the fourth quarter of the year. From the maturity point of view, the increase was a result of the increase of the longest-term government securities, i.e. the government bonds with maturity of 15 and 30 years. At the same time, shorter terms were registered for government securities, i.e., 2-year and 5-year government bonds and 12-month treasury bills. Such changes caused further growth of the long-term component of the total portfolio of government securities. Thus, the share of 15-year government bonds in the total amount of government securities in the fourth quarter increased by 3 percentage points and reached 37%, while the share of 12-month treasury bills declined by 0.4 percentage points and reduced to 31%. During the last quarter of the year, the stock of government securities without FX clause continued to grow, reaching 60%, while the amount of FX government securities declined and at the end of the year it accounted for 40% of the total amount of government securities issued on the primary market. From the ownership point of view, the growth of the government securities portfolio was registered with the category of other investors (mostly due to the growth of government securities owned by the pension funds), while the banks reduced the amount of government securities. Consequently, most of the total issued government securities are still owned by other investors (67%), where pension funds account for the largest share, while 33% of the total amount of government securities is owned by banks.



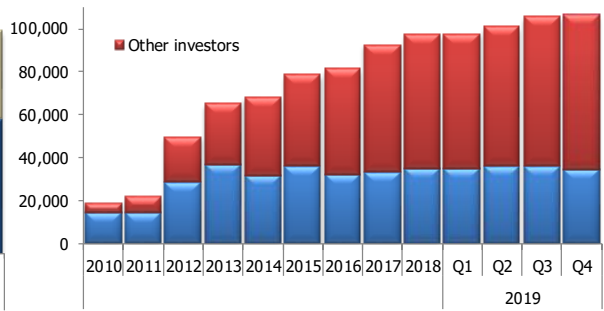


GS currency composition
(stocks, in million of denars)



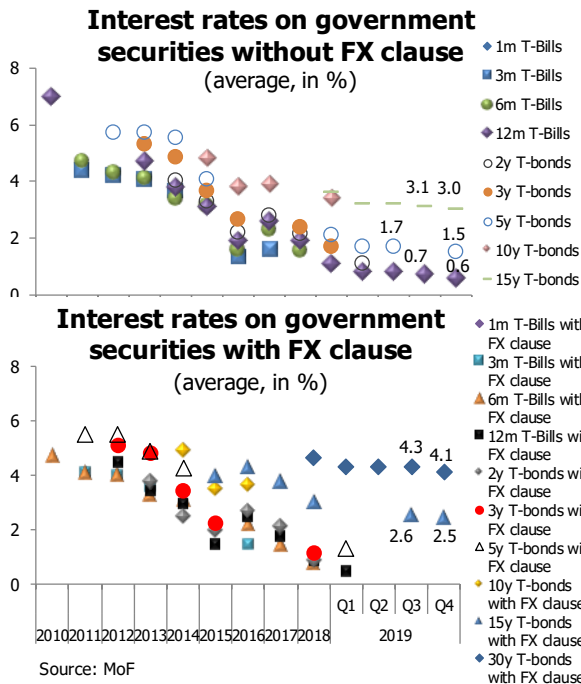
Source: MoF

GS ownership composition
(stocks, in million of denars)

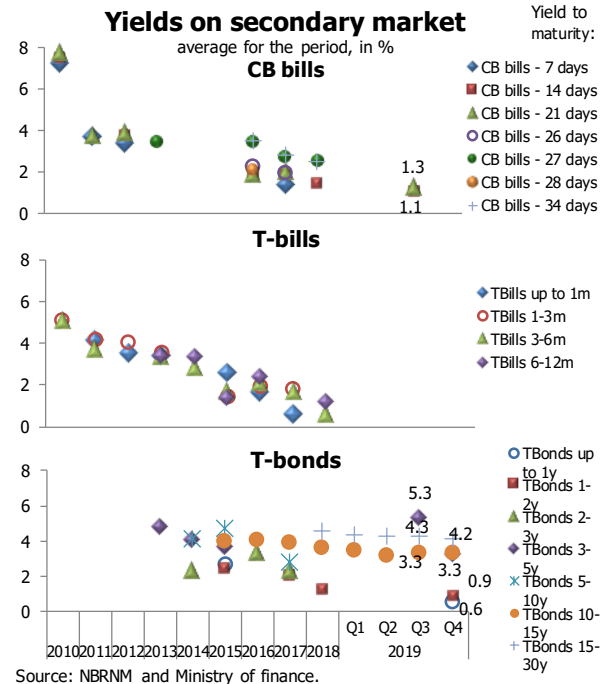


Source: MoF

Government securities that were sold on the primary market in the fourth quarter of the year registered lower interest rates compared to the previous quarter. Interest rates on 12-month treasury bills without currency clause, on 5-year treasury bills without currency clause, 15-year government bonds with and without currency clause and 30-year government bonds with currency clause equaled 0.6%, 1.5%, 2.5%, 3.0% and 4.1%, respectively.

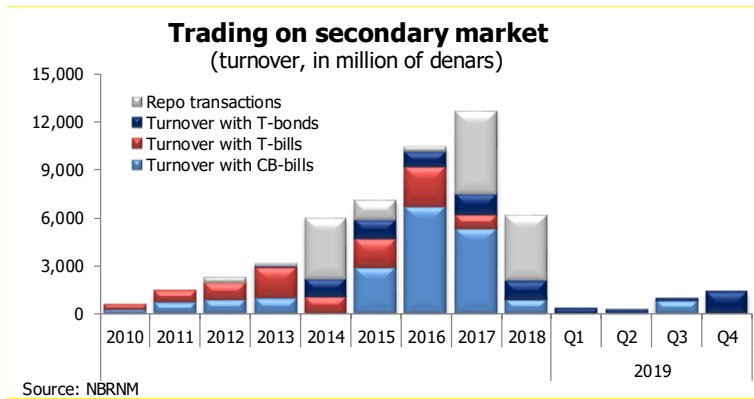


Source: MoF

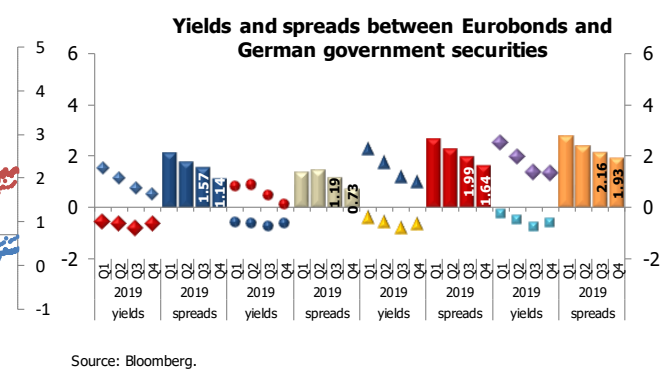
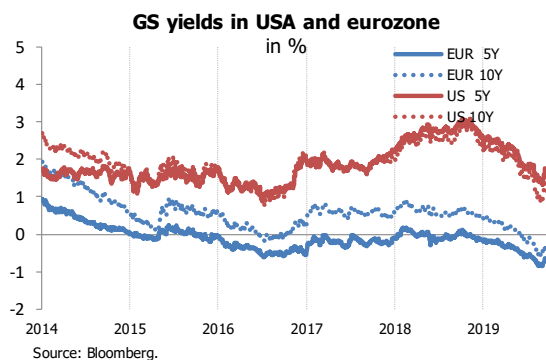


Source: NBRNM and Ministry of finance.

Trade in securities i.e. government bonds on the secondary market was higher in the fourth quarter compared to the previous quarter. From the viewpoint of the maturity segments where the government bond trading was realized, the realized transactions were with residual maturity of up to 1 year (with an average yield to maturity of 0.6%), 1 to 2 years (with an average yield to maturity of 0.9%), from 3 to 5 years (with an average yield to maturity of 2.6%), from 10 to 15 years (with an average yield to maturity of 3.3%) and from 15 to 30 years (with an average yield to maturity of 4.1%).

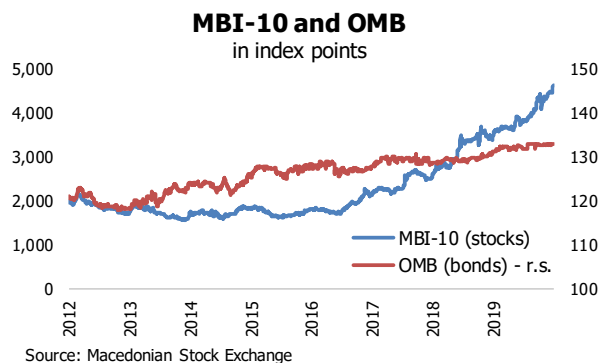
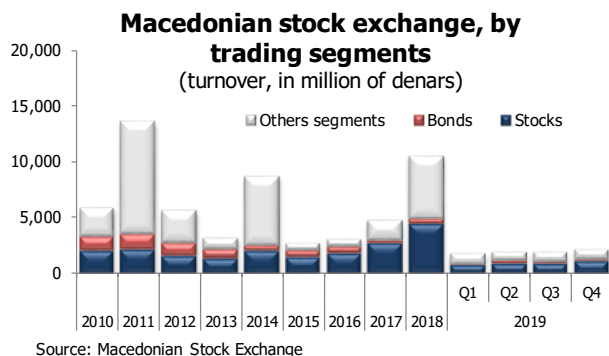


In the euro area and US financial markets, yields on long-term government bonds were upward in the fourth quarter of the year, amid investor expectations of a positive outcome from negotiations between the US and China over the "first phase" of the trade agreement. Despite these expectations, perceptions for downward risks to global economic growth are still present, with central banks globally still pursuing lax monetary policies. Under such conditions, in the euro area, yields on 10-year government securities rose moderately (on average -0.2% from -0.4% in the third quarter), while yields on US 10-year government bonds increased, but on average they did not change compared to the third quarter (1.8%). The yields of the Macedonian Eurobonds continued to decline, which, in conditions of increase in the yields of the German government bonds, contributed to further narrowing of the spread between them, which equaled 1.1 percentage points, 0.7 percentage points, 1.6 percentage points and 1.9 percentage points, respectively on average for the fourth quarter of the year.

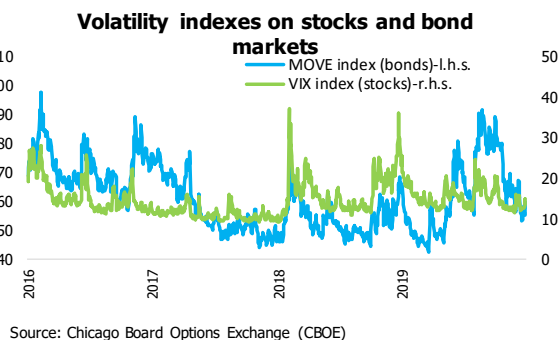
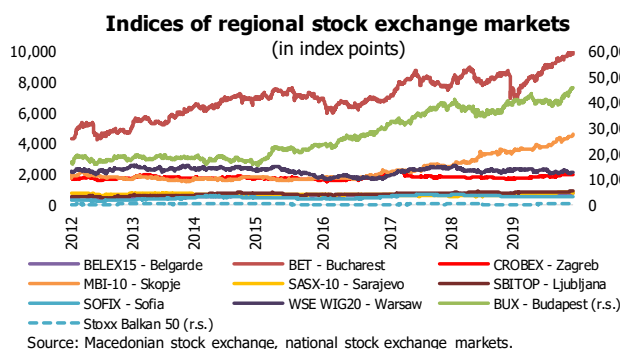


3.3 Stock Exchange Markets

On the Macedonian Stock Exchange, the value of the Stock Exchange Index (MBI-10) continued the upward trend and at the end of the fourth quarter was 4,649 (quarterly growth of 7%). Since the beginning of the year, the growth of MBI-10 has been 34%. The total turnover on the Macedonian Stock Exchange in the fourth quarter of the year was higher compared to the previous quarter, mostly as a result of the higher volume of share transactions. The value of the bond index (OMB) stood at 133 at the end of the fourth quarter and remained relatively stable during the quarter, with no changes compared to the end of the previous quarter.



On regional stock markets, the value of stock indices generally continued to rise. In the last quarter of the year, significant upward movements were registered in the Hungarian, Slovenian, Macedonian and Serbian stock indexes, which registered quarterly growth of 14%, 8%, 7% and 7%, respectively. Other stock market indices in the region also grew, except the Bosnian and Polish indices, whose value declined by 5% and 1% on a quarterly basis. Volatility indices on the bond and equity markets registered a downtrend during the fourth quarter, indicating lower uncertainty. The value of the VIX Index in the fourth quarter, on average, was 2% lower compared to the third quarter, while the MOVE index was on average 9% lower.



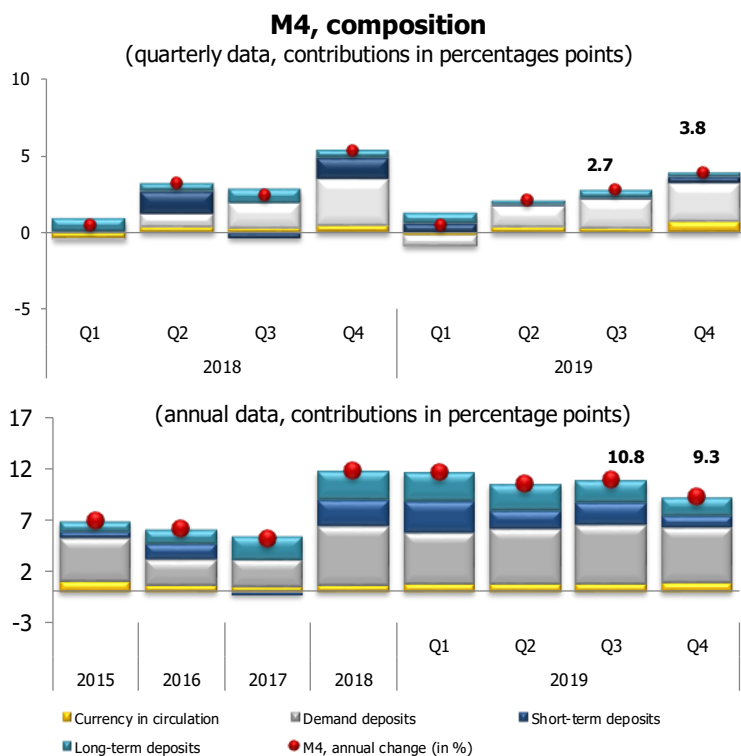
IV. Monetary and credit aggregates

In the fourth quarter of 2019, the favorable movements of the monetary aggregates continued. The broadest money continued to grow on a quarterly basis, with stronger dynamics compared to the previous period. Higher money supply in the economy during this period is common and in part is associated with certain seasonal factors, and partly reflects the better performances in the domestic economy. From a structural point of view, all components of money supply grew, with the largest contribution, usually for this period, accounting for the most liquid component, i.e. demand deposits. Analyzing by sector, the growth of total deposits of the financial system is primarily due to the household deposits amid solid growth of corporate deposits, with negative contribution of the deposits of other sectors. The higher level of deposits was further underpinned by the intensified credit support of banks in this period. Thus, the lending activity in the fourth quarter increased, given the significantly higher lending to the corporate sector, which is common for this period of the year. Such performances correspond with the results of the fourth quarter Bank Lending Survey that indicate a net increase in total loan demand amid further net easing of total credit standards.



4.1 Monetary aggregates

The quarterly growth of broad money M4 in the fourth quarter equaled 3.8% and is higher compared to the previous quarter (2.7%). The analysis of the money supply structure indicates that the growth acceleration is mostly due to the most liquid component, ie the demand deposits, which is usually the last quarter of the year. The other components of the broadest money supply, i.e. currency in circulation, also registered moderate growth, and the savings contributed positively to the growth. The deposit analysis by maturity indicates a simultaneous increase in both short-term and long-term deposits. In terms of currency structure, the deposit growth in the fourth quarter was mainly driven by denar deposits (with demand deposits included) with a positive contribution of 2.6 percentage points, while foreign currency deposits (0.5%) contributed slightly. Given the further denarization of the deposit base, the share of foreign currency deposits in M4 moderately decreased to 34.7% at the end of the fourth quarter (35.5% at the end of the previous quarter). Annually, the growth of broad money was 9.3% at the end of the fourth quarter (10.8% at the end of the third quarter).

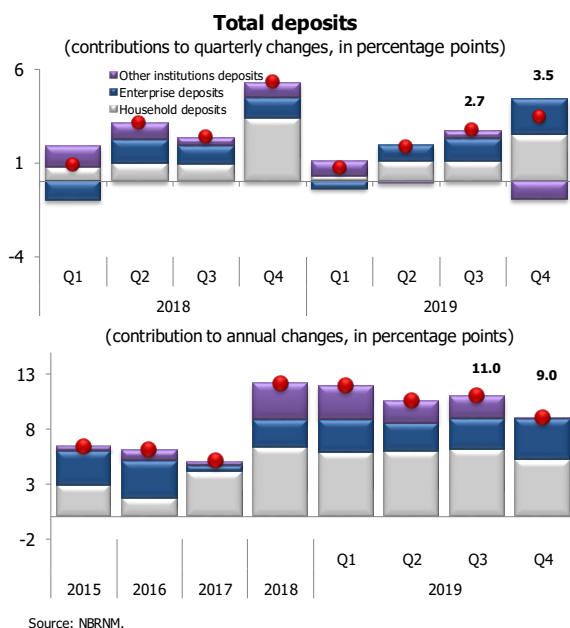


Source: NBRNM.

The total deposits in the financial system⁴⁷ in the fourth quarter of the year continued to grow with intensified dynamics, and their quarterly growth reached 3.5%. Analyzing by sector, the deposit increase is primarily due to the growth of household deposits amid solid growth of corporate deposits, with negative contribution of the deposits of other sectors⁴⁸. Observing by currency, denar deposits (including demand deposits) account for most of the growth of total deposits, amid moderate increase in foreign currency deposits. Analyzing the maturity structure, the growth mostly reflects the short-term deposits, amid growth of long-term deposits. On an annual basis, the growth of total deposits equaled 9.5% at the end of December (11.0% at the end of September).

⁴⁷Data refer to non-government deposits in banks and savings houses, funds of other financial institutions on the accounts with the National Bank and funds of local government authorities on the accounts with the National Bank. The data are consistent with the methodological changes of the National Bank from June 2018. For more information on the methodological changes visit: http://www.nbrm.mk/monetarna_statistika_i_statistika_na_kamatni_stapki.nspk.

⁴⁸In November, there was a decline in transferable denar deposits of other financial institutions with the NBRNM, due to financial transactions related to change of ownership structure in the banking system.



	2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %								
Total deposits	0.9	3.1	2.4	5.3	0.7	1.9	2.7	3.5
contributions to quarterly growth, p.p.								
Deposit money	-0.1	1.0	1.7	3.3	-0.7	1.4	2.0	2.7
Denar deposits	0.5	0.7	0.6	0.8	0.4	0.5	0.1	0.1
FX deposits	0.5	1.4	0.1	1.2	0.9	-0.1	0.6	0.6
Short-term deposits	0.1	1.5	-0.4	1.5	0.6	0.1	0.2	0.4
Long-term deposits	0.9	0.6	1.0	0.6	0.8	0.3	0.5	0.3
Households	0.8	1.0	0.9	3.4	0.3	1.1	1.1	2.5
Enterprises	-1.0	1.3	1.0	1.1	-0.4	0.9	1.2	1.9
Other institutions deposits	1.1	0.8	0.4	0.8	0.8	-0.1	0.4	-1.0

Source: NBRNM.

In the fourth quarter of the year, the household deposits registered stronger growth dynamics compared to the previous three quarters. The quarterly growth of household deposits of 3.9% (1.7% in the previous quarter), in terms of currency, is mainly due to the higher denar deposits (including demand deposits), amid simultaneous growth of foreign currency deposits. The solid growth on a quarterly basis is largely associated with certain seasonal factors that are characteristic for the year, such as early retirement payments⁴⁹ and part of private sector wages, the usual end-of-year bonus payments, as well as government subsidy payments during this period. Additional contribution was made by the further banks' solid credit support for households. By maturity, the growth of household deposits was mostly a result of the increased short-term deposits, amid moderate growth of long-term deposits. The annual increase in total household deposits was 7.9% at the end of December (9.3% in September).

Corporate deposits in the fourth quarter registered strong quarterly growth of 7.5% (4.7% in the third quarter), which according to the currency structure, mostly derives from the denar deposits, i.e. from the demand deposits, amid moderate growth of the foreign currency deposits. Apart from the favorable developments in the real sector (growth of the economy in the third quarter and the relatively favorable high frequency indicators for the fourth quarter), the increased credit support by the banks in this sector in the recent quarter may also be an additional factor for the enhanced deposit growth of the companies, contributing to the multiplier effect of lending on corporate sector deposits. From maturity aspect, the short-term deposits registered an increase, as opposed to their negative contribution in the last three quarters, given further growth of long-term deposits. On an annual basis, corporate deposits increased by 14.6% at the end of December, which is a faster increase than that at the end of the previous quarter (of 11.1%).

⁴⁹ Some banks paid the December pension at the end of December.



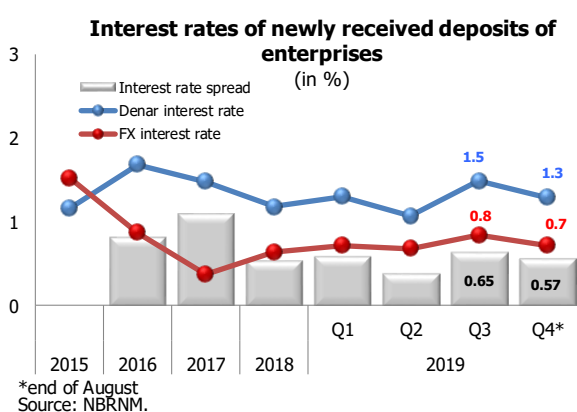
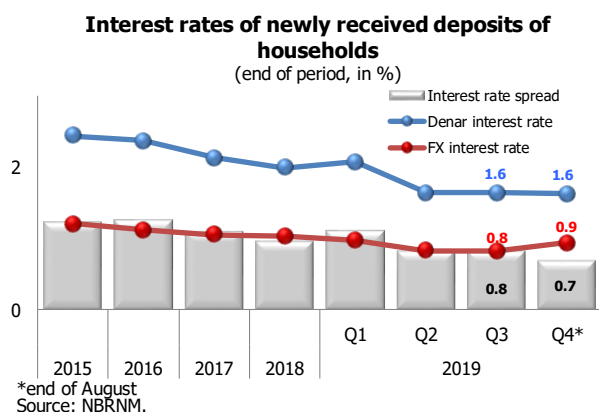
Household deposits	2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %								
Total household deposits	1.2	1.4	1.4	5.2	0.5	1.7	1.7	3.9
contribution to quarterly change of total deposits, in p.p.								
Deposit money	-0.1	0.3	0.4	3.4	-0.8	1.2	0.5	3.1
Denar deposits	0.5	0.1	0.2	0.7	0.6	0.2	0.2	0.3
FX deposits	0.8	1.1	0.8	1.1	0.7	0.3	1.0	0.5
Short-term deposits	0.5	0.7	0.2	0.8	0.5	0.1	0.8	0.5
Long-term deposits	0.8	0.5	0.8	0.9	0.8	0.3	0.4	0.2

Source: NBRNM.

Enterprise deposits	2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %								
Total household deposits	-3.9	5.3	3.9	4.2	-1.6	3.4	4.7	7.5
contribution to quarterly change of total deposits, in p.p.								
Deposit money	-2.7	1.7	5.6	0.6	-2.1	3.6	4.9	6.1
Denar deposits	-1.2	1.2	0.0	1.4	-0.8	0.9	-0.3	0.0
FX deposits	0.0	2.3	-1.7	2.2	1.3	-1.1	0.2	1.4
Short-term deposits	-1.4	3.7	-2.0	3.8	-0.1	-0.5	-0.2	0.6
Long-term deposits	0.2	-0.1	0.2	-0.2	0.6	0.3	0.1	0.8

Source: NBRNM.

According to the yield analysis⁵⁰ of new savings, in November, the interest rate on newly accepted denar deposits of households did not change compared to the previous quarter, amounting to 1.6%, while interest rate on foreign currency deposits surged by 0.1 percentage point, accounting for 0.9%. In such conditions, the interest rate spread between the new denar and foreign currency savings of households in November narrowed relative to September (by 0.1 percentage points) to 0.7 percentage points. Interest rates on newly accepted denar and foreign currency corporate deposits decreased by 0.2 percentage points and 0.1 percentage points respectively compared to September and equaled 1.3% and 0.7%, respectively in November. With these developments, the interest rate spread between denar and foreign currency corporate deposits in November remained stable and amounted to 0.6 percentage points. Analyzing the total accepted deposits, interest rates on household and corporate deposits (denar and foreign currency) in November decreased intangibly by 0.1 percentage points respectively compared to September and equaled 1.2% and 1.6%, respectively.



4.2 Lending activity

Private sector loans increased in the fourth quarter, despite the slight decline in the previous quarter, which was a result of regulatory amendments⁵¹. The fourth quarter also registered gradual depletion of the effect of the amendments to the National Bank regulation on transferring part of the banks' doubtful and contested claims to the off-balance sheet record. Thus, in the last three months of

⁵⁰ Data on interest rates are in accordance with the methodological changes of the National Bank from June 2018. For more information on the methodological changes visit:

http://www.nbrm.mk/monetarna_statistika_i_statistika_na_kamatni_stapki.nspix.

⁵¹ On 9 August 2018, the National Bank Council adopted the Decision on the methodology for credit risk management (Official Gazette of the Republic of Macedonia No. 149/18) that requires from banks to transfer from the on-balance sheet to the off-balance sheet records (and to continue to transfer) all pass due claims that have been fully booked for more than one year. Notwithstanding the transfer of these claims to the off-balance sheet record, the banks reserve the right for collection. The implementation of the Decision started from July 2019.

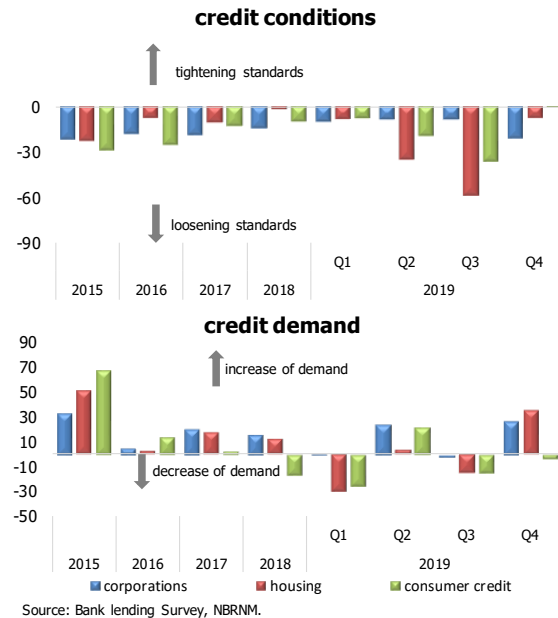


2019, total loans increased by 3.8%, compared to the drop of 0.5% in the previous quarter. The Bank Lending Survey⁵² for the fourth quarter indicates a net increase in the total loan demand, amid further net easing of total credit standards. For the first quarter of 2020, banks expect a net increase in total credit demand by both sectors, with further net easing of total lending conditions.

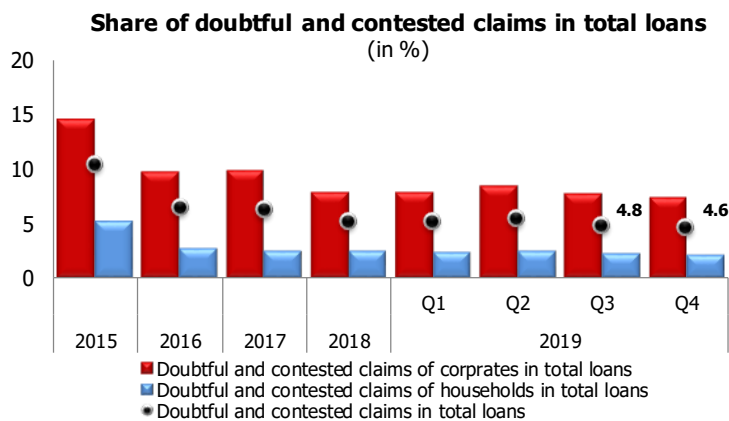
Total credits of private sector

	2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %								
Total credits of private sector	-0.7	2.7	1.8	3.4	0.8	1.8	-0.5	3.8
Contribution in quarterly change of total credits (in p.p.)								
Denar credits	-0.6	1.6	1.1	3.4	0.4	0.8	-0.8	2.0
Foreign currency credits	-0.2	1.1	0.7	0.0	0.5	1.0	0.3	1.8
Short-term credits	-0.8	0.6	0.0	1.5	-0.1	-0.3	-0.9	0.6
Long-term credits	1.3	2.0	1.7	1.6	0.8	1.8	1.2	3.2
Households	1.1	1.6	1.2	0.9	0.9	1.7	1.1	1.4
Corporations	-1.8	1.1	0.6	2.4	0.0	0.2	-1.7	2.5

Source: NBRNM.



The analysis of the sector structure of private sector loans indicates that the quarterly growth is largely due to the increase in corporate loans, amid simultaneous growth of household loans. From the currency point of view, the growth primarily comes from the denar loans, amid the growth of the foreign currency loans⁵³. Analyzing the maturity structure, the quarterly growth of total loans was largely due to long-term loans, amid slower growth of short-term loans. Also, the share of doubtful and contested claims in total loans at the end of December decreased by 0.2 percentage points compared to September and reduced to 4.6%.



On annual basis, total loans grew by 6.0% at the end of the fourth quarter, which is a moderate acceleration compared to the previous quarter (5.6%). The annual growth of total loans is still primarily due to the growth of household loans, amid slight contribution of corporate loans. At the end of

⁵² For more information, also see Bank Lending Survey at <http://nbrm.mk/?ItemID=F7AC78DEE498764FBAF39049F726CE3C>.

⁵³ Foreign currency loan data also include denar loans with currency clause.



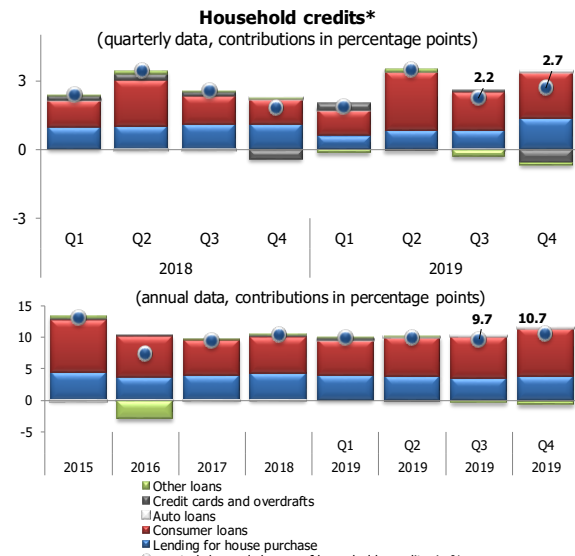
December, loan-to-deposit ratio registered a slight increase and equaled 81.4% (81.2% at the end of September).

During the fourth quarter of 2019, the growth of household lending accelerated compared to the previous quarter. The quarterly growth of 2.7% (2.2% in the third quarter) was mainly due to the increase in consumer loans, given further positive contribution of housing loans and other loans, while credit cards and overdrafts on current accounts registered a small decline. The Bank Lending Survey for the fourth quarter indicates a net increase in the housing loan demand and net decrease in consumer loan demand, amid further net easing of the credit standards. From the currency point of view, the growth of household loans stems almost from the increase in both denar and foreign currency loans (including FX loans). In terms of maturity structure, the quarterly growth stems from increase in long-term loans, amid drop of short-term loans. Annually, at the end of December, total household loans increased by 10.5% (9.5% at the end of September).

Total credits of households

	2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %								
Total credits of households	2.3	3.3	2.5	1.8	1.8	3.4	2.2	2.7
Contribution in quarterly change of household credits (in p.p.)								
Denar credits	1.4	2.4	1.7	1.1	1.6	1.7	0.8	1.3
Foreign currency credits	0.9	0.9	0.8	0.7	0.2	1.7	1.4	1.3
Short-term credits	0.3	0.3	0.2	-0.3	0.4	0.0	0.0	-0.3
Long-term credits	2.0	2.9	2.3	2.1	1.4	3.2	2.5	3.1

Source: NBRNM.



*Total loans to households do not include loans to self-employed individuals. Source: NBRNM.

In the fourth quarter of 2019, total loans to the corporate sector increased, despite the decline in the previous quarter, which was a result of regulatory changes. Corporate loans in the last quarter of 2019 experienced solid growth of 5.1% (drop of 3.4% in the previous period). The Bank Lending Survey for the fourth quarter indicates a net increase in the corporate loan demand, amid eased credit standards. From the currency point of view, the growth of total corporate loans is primarily a result of the increase in denar loans, amid simultaneous growth in foreign currency loans. According to the maturity structure analysis, the quarterly growth stems from the long-term loans, amid the growth of short-term loans. Annually, at the end of December, total corporate loans increased by 1.9% (1.7% at the end of September).

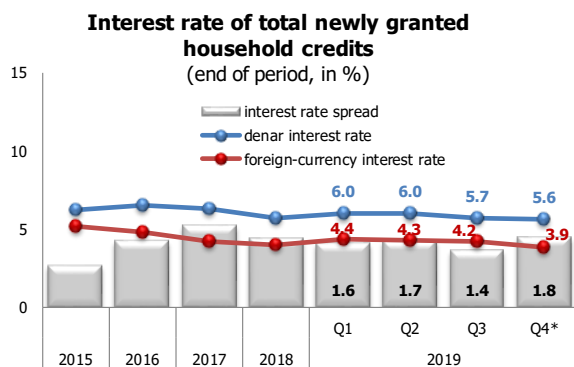
Total credits of corporations

	2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
quarterly change, in %								
Total credits of corporations	-3.5	2.1	1.1	4.8	0.0	0.3	-3.4	5.1
Contribution in quarterly change of corporation credits (in p.p.)								
Denar credits	-2.4	0.9	0.5	5.5	-0.8	0.1	-2.5	2.7
Foreign currency credits	-1.1	1.2	0.6	-0.7	0.7	0.2	-0.9	2.4
Short-term credits	-1.8	0.8	-0.1	3.3	-0.5	-0.7	-2.0	1.8
Long-term credits	0.7	1.1	1.2	1.0	0.4	0.4	-0.1	3.5

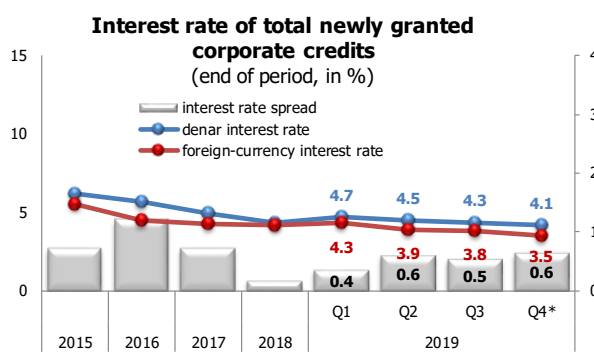
Source: NBRNM.



According to the data on interest rates⁵⁴ on newly approved loans⁵⁵ in November, interest rates on denar and foreign currency loans to households dropped to 5.6% and 3.9%, respectively (in the previous quarter 5.7% and 4.2%, respectively), which widened the interest rate spread to 1.8 percentage points (1.4 percentage points in the previous period). With the enterprises, the interest rates on the newly extended denar and foreign currency loans in November decreased to 4.1% and 3.5%, respectively (previously 4.3% and 3.8%, respectively), with the interest rate spread being minimally expanded to 0.6 percentage points (0.5 percentage points in the previous period). With respect to total loans to the private sector, interest rates on loans to households and enterprises dropped to 5.7% and 4.2% at the end of November, respectively (5.8% and 4.3%, respectively in September).



*End of Source: November
Source: NBRNM.



*End of November
Source: NBRNM.

V. Public finances

In the third quarter of 2019, budget revenues and expenditures increased annually by 11.0% and 7.6%, respectively. The increase in budget revenues largely stems from the increase in taxes and contributions, while the increase in budget expenditures, apart from current costs, also results from capital expenditures. The budget deficit is 0.2% of GDP and is slightly lower compared to the realization in the same quarter of last year (0.4% of GDP). For the past eleven months of the year, the budget deficit is 1.1% of GDP, representing 42% of the 2019 Budget Revision. In the period January - November the budget deficit was financed through domestic and foreign borrowing, with some of the funds accumulated as government deposits with the National Bank. At the end of the third quarter of 2019, total public debt equaled 48.6% of GDP, which is by 0.9 percentage points of GDP more compared to the previous quarter.

In the third quarter of 2019, the total revenues in the Budget of the Republic of North Macedonia⁵⁶ were by 11.0% higher on an annual basis. The increase in budget revenues is largely a result of higher tax and contribution performance (with a contribution of 6.0 percentage points, 3.4

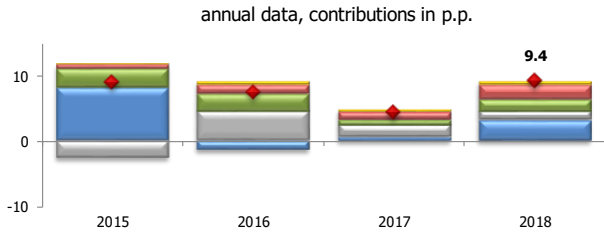
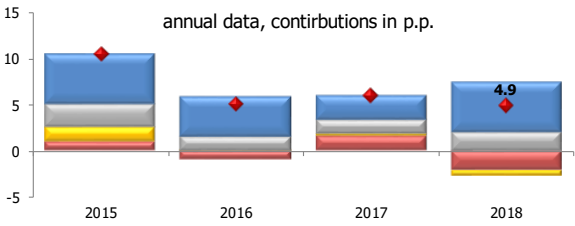
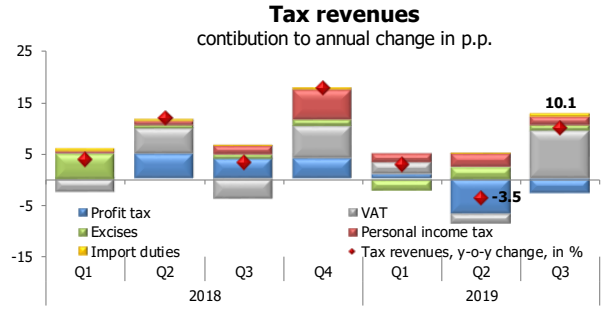
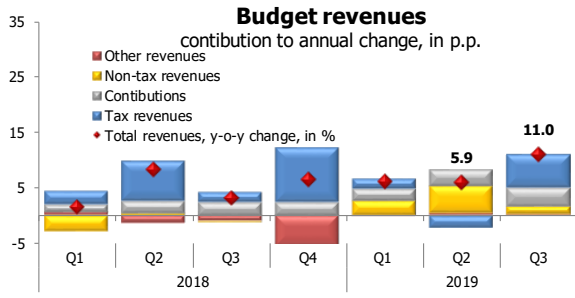
⁵⁴ Data on interest rates are in accordance with the methodological changes of the National Bank from June 2018. For more information on the methodological changes visit: http://www.nbrm.mk/monetarna_statistika_i_statistika_na_kamatni_stapki.nsp.x.

⁵⁵ One should have in mind that the interest rates on newly approved loans are volatile. Volatility of interest rate on newly approved loans results from the fact that they are driven by the volume of newly approved loans (which can vary from month to month) and their interest rate.

⁵⁶ Central budget and budgets of funds.



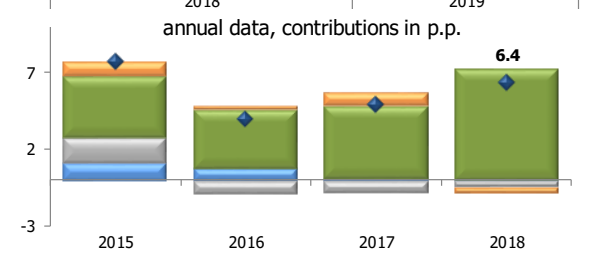
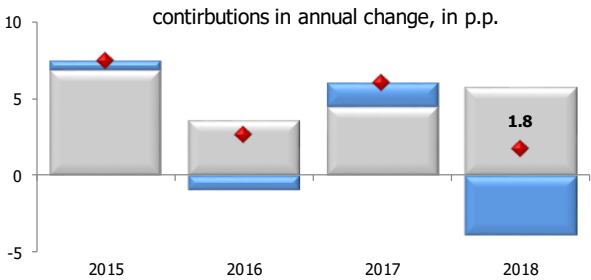
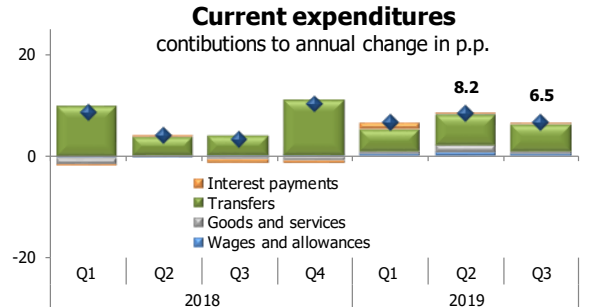
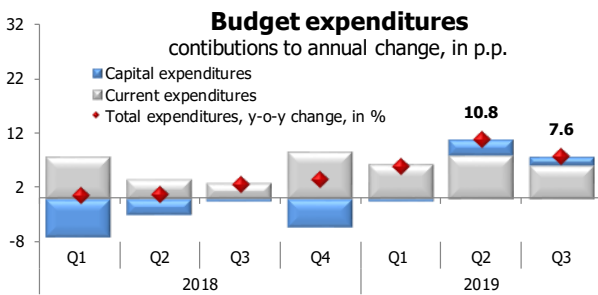
percentage points, respectively), amid rising, but to a lesser extent, non-tax revenues⁵⁷ and other revenues (contributing 1.4 and 0.2 percentage points, respectively).



*Other revenues includes capital revenues, foreign donations and revenues from due loans.
Sources: Ministry of finance and NBRNM's calculations.

Source: Ministry of finance and NBRNM's calculations

In the same period, total tax revenues⁵⁸ increased by 10.1% on an annual basis. The increase in tax revenue stems from higher VAT revenues, personal income tax, excise duties and import duties (contributing 9.4 percentage points, 1.7 percentage points, 1.0 percentage points and 0.8 percentage points, respectively), while profit tax revenue has a negative contribution (2.8 percentage points).



Source: Ministry of finance.

Source: Ministry of finance and NBRNM's calculations.

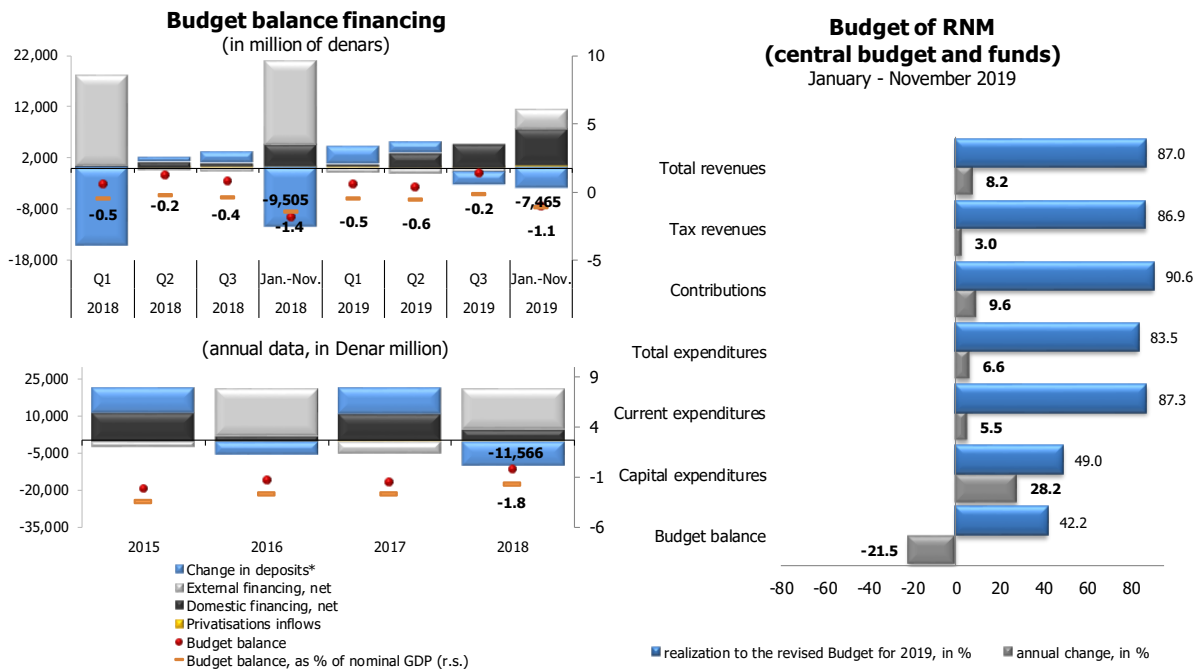
Total expenditures in the Budget in the third quarter of 2019 were by 7.6% higher on an annual basis. The growth is largely due to higher current costs (contributing 6.1 percentage points), with a

⁵⁷ Higher non-tax revenues were mostly due to inflows to the Pension and Disability Insurance Fund's account in the RNM Budget. These inflows are a result of the transfer of funds of the private pension funds in accordance with the Law on Mandatory Fully Funded Pension Insurance and the Law Amending the Law on Pension and Disability Insurance (Official Gazette of RM No. 245 of 28 December 2018). With these amendments, the membership of some insuror categories in the second pillar of the pension system ceased on 1 January 2019.

⁵⁸ It also includes own revenue accounts (SSP).



growth, but slight, being registered in capital expenditures. In the third quarter, total current expenditures increased by 6.5% on annual basis, with the "transfers" category having the highest contribution to the growth (5.5 percentage points).



* Positive change - deposits withdrawal; negative change - deposits accumulation.
Source: Ministry of finance

Source: Ministry of Finance and NBRNM's calculations

In the third quarter of 2019, the Budget deficit was Denar 1,098 million or 0.2% of GDP⁵⁹, which is a weaker performance compared to the same period last year (0.4% of GDP). The deficit was fully funded through government borrowing on the domestic financial market, with a portion of the funds being accumulated on the government accounts with the National Bank.

BUDGET OF REPUBLIC OF NORTH MACEDONIA (Central budget and budgets of funds)

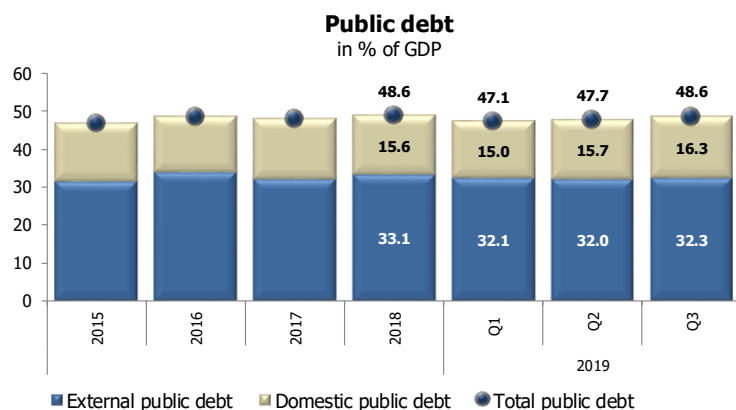
	2019													
	Budget for 2019	Revised Budget for 2019	Q1	Q2	Q3	Jan.-Nov.	Q1		Q2		Q3		Jan.-Nov.	
							Annual changes, period in Q1 2019, in %	Contributions in annual changes, period in Q1 2019, in p.p.	Annual changes, period in Q2 2019, in %	Contributions in annual changes, period in Q2 2019, in p.p.	Annual changes, period in Q3 2019, in %	Contributions in annual changes, period in Q3 2019, in p.p.	Annual changes, period in January to November 2019, in %	Contributions in annual changes, period in January to November 2019, in p.p.
TOTAL REVENUES	210,848	210,551	46,041	50,077	51,034	183,202	6.2	6.2	5.9	5.9	11.0	11.0	8.2	8.2
Tax revenues and contributions	184,201	184,037	40,644	43,912	45,788	161,611	4.4	4.0	0.9	0.8	10.5	9.4	5.1	4.6
Taxes	120,166	120,166	26,271	28,191	29,677	104,415	2.9	1.7	-3.3	-2.0	10.5	6.1	3.0	1.8
Contributions	62,316	61,460	14,060	15,357	15,603	55,707	7.7	2.3	10.2	3.0	11.1	3.4	9.6	2.9
Non-tax revenues	18,521	19,145	4,291	4,993	3,642	16,449	34.2	2.5	82.3	4.8	20.6	1.4	49.7	3.2
Capital revenues	2,026	2,026	218	177	931	1,655	-52.2	-0.5	-50.1	-0.4	0.4	0.0	-18.6	-0.2
Foreign donations	6,000	5,243	888	995	673	3,487	12.7	0.2	57.4	0.8	17.2	0.2	36.6	0.6
TOTAL EXPENDITURES	228,548	228,251	49,245	53,917	52,132	190,667	5.9	5.9	10.8	10.8	7.6	7.6	6.6	6.6
Current expenditures	202,577	205,542	47,630	50,252	48,857	179,535	6.5	6.3	8.2	7.8	6.5	6.1	5.5	5.2
Capital expenditures	25,971	22,709	1,615	3,665	3,275	11,132	-10.0	-0.4	64.6	3.0	27.1	1.4	28.2	1.4
BUDGET DEFICIT/SURPLUS	-17,700	-17,700	-3,204	-3,840	-1,098	-7,465								
Financing	17,700	17,700	3,204	3,840	1,098	7,465								
Inflow	34,195	34,007	7,712	8,230	2,340	22,477								
Privatisation receipts	100	373	168	51	127	512								
Foreign loans	25,416	10,140	64	853	106	8,737								
Deposits	-10,325	4,464	3,233	2,201	-2,550	-4,008								
Treasury bills	19,001	19,001	4,217	5,125	4,657	17,206								
Sale of shares	3	30	30	0	0	30								
Outflow	16,495	16,307	4,508	4,390	1,242	15,012								
Repayment of principal	16,495	16,307	4,508	4,390	1,242	15,012								
External debt	6,175	5,987	855	1,926	926	4,718								
Domestic debt	10,320	10,320	3,653	2,464	316	10,294								

Source: Ministry of Finance and NBRNM calculations.

⁵⁹ The analysis uses the National Bank October forecast for the nominal GDP for 2019.



In the period January - November 2019, total budget revenues increased by 8.2% compared to the same period last year. The growth is largely due to the better performances mainly in contributions, non-tax revenues and taxes (contribution of 3.2 percentage points, 2.9 percentage points and 1.8 percentage points, respectively). In the same period, the budget expenditures increased by 6.6% annually mostly due to the increase in current expenditures with a contribution of 5.2 percentage points, amid positive contribution of capital expenditures of 1.4 percentage points. In the last eleven month of the year, the budget deficit totaled Denar 7,465 million or 1.1% of GDP. The budget deficit constitutes 42% of the Budget revision for 2019. Budget deficit was mostly financed by domestic and foreign⁶⁰ borrowing, with one part of the inflows being retained as a deposit on the government account with the National Bank.



At the end of the third quarter of 2019, total public debt⁶¹ was 48.6% of GDP⁶², which is a quarterly increase of 0.9 percentage points. Analyzing the structure, such increase is due to the growth of the internal debt from 15.7% to 16.3% of GDP, amid small increase in the external debt from 32.0% to 32.3% of GDP. In terms of debt structure, total government debt⁶³ accounted for 40.0% of GDP, increasing by 0.6 percentage points. Compared to the previous quarter, while public debt (guaranteed and non-guaranteed)⁶⁴ increased by 0.3 percentage points and reached 8.6% of GDP. Compared to the same period last year, total public debt was higher by 0.5 percentage points of GDP, while compared to the end of 2018, total public debt remained unchanged.

⁶⁰ Taking out a loan from the World Bank in the amount of Euro 125 million, in October 2019, intended for implementation of development policies for public finances and competitiveness.

⁶¹ The public debt is defined under the Law on Public Debt (Official Gazette No. 62/05, 88/08, 35/11, 139/14 and 98/19) as the sum of the government debt and the debt of public companies established by the state or municipalities, municipalities within the City of Skopje and the City of Skopje, and companies that are entirely or predominantly owned by the state or by the municipalities, the municipalities within the City of Skopje and the City of Skopje.

⁶² At the end of the third quarter of 2019, the total public debt equals Euro 5,405 million.

⁶³ Government debt is defined as a sum of debts of the central and the local government.

⁶⁴ Pursuant to the amendments to the Law on Public Debt Law of May 2019, the debt of public enterprises and joint stock companies established by the state or by municipalities, municipalities in the City of Skopje and the City of Skopje is calculated in public debt (Official Gazette No. 62/05, 88/08, 35/11, 139/14 and 98/19).



VI. Analytical appendices

Annex 1. Monetary and fiscal policy setup in the countries of Central, Eastern and Southeastern Europe (CESEE)

Macroeconomic policies are an extremely important aspect of any economy, and changes in their setting have important implications. Therefore, it is not odd to emphasize the importance of proper policy setting and their coordination. Complexity is particularly pronounced in times of negative shocks. The global financial crisis that was followed by a slow economic recovery has further emphasized the need for a policy mix that will not only strengthen the resilience of economies to major economic shocks, but also provide support to post-crisis economies. In this context, **we will try to make a brief, succinct overview of the set-up of macroeconomic policies - monetary and fiscal policy, in the period following the onset of the global economic crisis in the CESEE countries, as well as on the challenges they are currently facing.**

During the entire post-crisis period, monetary policy in the CESEE countries, in conditions of low and stable inflation rates, often below target levels, was generally adjustable and aimed at stimulating real economic activity. Central banks in this region have responded by applying conventional, standard instruments, especially with changes in key interest rates, and depending on the specific situation and factors, have also used unconventional instruments, such as liquidity support measures, targeted credit support measures⁶⁵ and measures aimed at maintaining exchange rate stability⁶⁶. Regarding the key interest rates, the CESEE countries included in the average analysis in 2019 have lower interest rates by 6.6 percentage points. (compared to 2008), but in some countries the adjustment is even more pronounced (Figure 1). For example, the key interest rate in Serbia in 2019 is 2.25% compared to 17.8% in 2008. In our economy, the key interest rate, i.e. the interest rate on CB bills, decreased from 7% in 2008 and reduced to 2.25% in 2019.

Fiscal policy was largely expansive, and the degree of expansion was conditioned by the fiscal space available at the beginning of the global financial crisis in each economy. Nearly all CESEE countries immediately after the crisis period registered worsened fiscal position, widened budget deficit (in part and as a result of automatic stabilizers) and increased public debt. Thus, on average, the region's deficit increased from 2.3% of GDP in 2008 to more than 4% of GDP in 2009 and 2010, amid a simultaneous growth of public debt in the region of 28.3% in 2008 to nearly 40% in 2010⁶⁷. In order to stimulate the economy, policy makers in a number of countries have taken discretionary fiscal measures, which have at the same time deteriorated the structural balance. However, unlike monetary policy that has been adjustable throughout the post-crisis period, fiscal consolidation has been taking place in the public finance in the last few years. The budget deficit in the region is gradually narrowing to only 0.84% of GDP in 2018, which conditioned also stabilization, and then decrease in the public debt in the region. Thus, after 2015 when public debt in CESEE reaches its peak (50.1% of GDP), a period of downward adjustment follows, with 2018 public debt positioning at 45.3% of GDP. When it comes to the Macedonian economy, the pre-crisis period is characterized by the implementation of relatively prudent fiscal policy, which in turn created fiscal space for countercyclical activity in the post-crisis period. Thus, until 2014 there is continuous expansion of the budget deficit (from 0.9% of GDP as it was in 2008 the budget deficit expanded to 4.2% of GDP in 2014), while

⁶⁵ Examples of this type of measures are the Funding for Growth Scheme to support lending to small and medium-size enterprises introduced by the National Bank of Hungary in 2013; reduction in the rate of minimum required foreign currency assets of banks (introduced in 2011) and targeted reduction of the reserve requirement (introduced in 2012) by the Bank of Croatia; reduction of the reserve requirement calculation base for the amount of loans that banks will approve under the Government of Serbia's Subsidized Lending Programs introduced by the Bank of Serbia in 2009. These measures were introduced with a limited period of application.

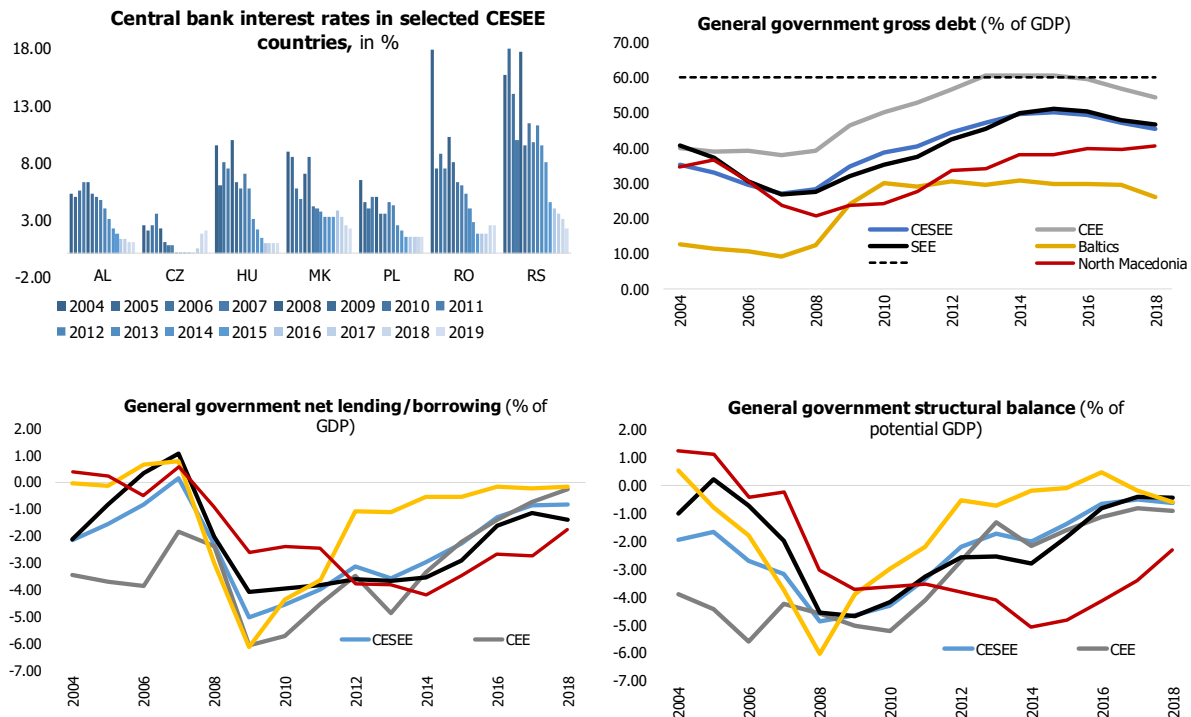
⁶⁶ For example, the Bank of Poland, in order to improve the liquidity of the foreign exchange market and reduce the pressures on the exchange rate at the end of 2008, started implementing foreign exchange swaps to create liquidity in euro, US dollars and Swiss francs. The measure lasted several months. Similar measures have been introduced by the central banks of Hungary and Romania.

⁶⁷ IMF, World Economic Outlook - database.



starting from 2015 there is a gradual stabilization of public finances. Such shifts also affected the path of government debt, which in 2014 reached about 38% of GDP (compared to 20.6% of GDP in 2008), while after 2015 there was a slowdown in growth (in 2018 debt accounts for about 40% of GDP)⁶⁸.

Chart 1



* The structural budget deficit for all countries (with the exception of North Macedonia) is from the IMF database. It is defined as a cyclically adjusted budget balance additionally adjusted for certain non-structural elements (temporary shocks in the financial sector or real estate prices, as well as one-off or temporary budget revenues or expenditures). A. Fedelino, A. Ivanova and M. Horton "Computing Cyclically Adjusted Balances and Automatic Stabilizers" IMF Technical Guidance Note No. 5, <http://www.imf.org/external/pubs/ft/tnm/2009/tnm0905.pdf>. Data on North Macedonia is calculated by the NBRNM and refers to the cyclically adjusted budget deficit.

Source: IMF, World Economic Outlook - database, NBRNM, central banks of individual economies and own calculations.

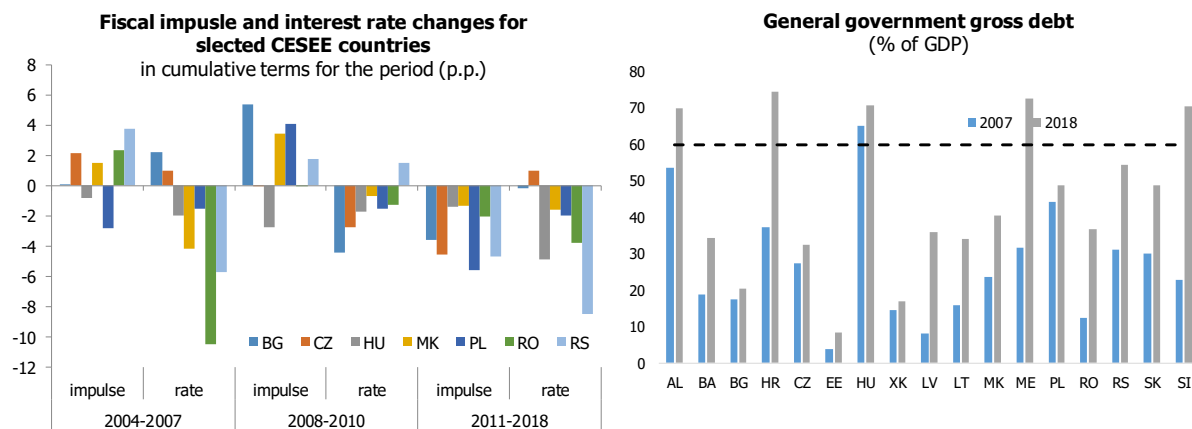
Chart 2 presents the changes in the core interest rate and the fiscal impulse⁶⁹, on a cumulative basis, in some of the CESEE countries, for which data are available. This set of indicators, as well, points to similar conclusions as previously emphasized - during the crisis, the fiscal impulse, which is generally small in the pre-crisis period, is expanding significantly in some countries in the region. Monetary policy also acts to underpin the real economy, by lowering key interest rates. After the crisis, as emphasized above, public finances stabilized and the fiscal impulse becomes negative (reduction in the structurally adjusted budget deficit), which, in conditions of low and stable inflation rates, creates room for the resumption of stimulating monetary policy. In our economy, in the period after the beginning of the crisis until 2014 the fiscal impulse was positive, while after 2014, consolidation of public finances and deficit reduction was registered, where the fiscal impulse became negative. Cumulatively for the period 2011-2018, the fiscal impulse in the Macedonian economy is negative, but relatively lower than in the rest of the countries included in the analysis. Interest rates follow a downward path in all countries included in the analysis, with the cumulative change for the period 2011-2018 being negative in almost all countries. The exception is the Czech

⁶⁸ Public debt data are taken from the IMF, World Economic Outlook - database. The data on N. Macedonia in this database corresponds to the national definition of government debt.

⁶⁹ Fiscal impulse is calculated as the difference in the structurally adjusted budget balance expressed as a% of GDP between two years (in the calculations the deficit is in positive sign, i.e. the surplus in negative sign). Negative fiscal momentum means a reduction in the structurally adjusted budget balance.



Republic where the cumulative change is positive as a result of the stabilization of the monetary policy in the second half of 2017 and the consequent increase in the key interest rate.

Chart 2

Source: IMF, World Economic Outlook Database, NBRNM, Eurostat, central banks of individual economies and own calculations.

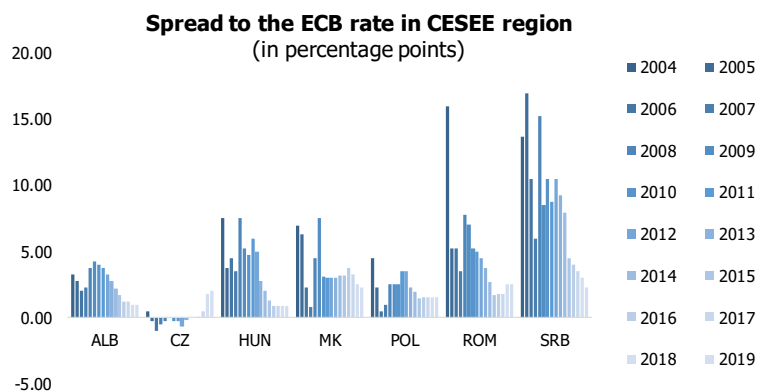
The assessment of the adequacy of the mutual monetary and fiscal policy setup is a complex and multidimensional task. It should be emphasized that certain measures and policy changes are also conditioned by the specific characteristics and factors of each country. For example, the monetary response depends on the country's chosen exchange rate regime. Also, a factor influencing policy setting is the initial state of each economy at the beginning of the crisis. For example, most of the countries in the region had relatively comfortable fiscal positions, which enabled them to use fiscal tools to stimulate the economy during the crisis. However, several countries that had accumulated vulnerabilities in the pre-crisis period were limited to the possibility of using the monetary-fiscal mix as a tool to stimulate the economy (Hungary, the Baltic countries). **But overall, an effective policy mix, as a final result, should deliver macroeconomic stability to the economy.** In CESEE, as can be seen from Chart 2 (right panel), the macroeconomic stability, measured by growth volatility, deteriorates significantly during the global crisis, with worsening in the Baltic states being the most pronounced. Exceptions are North Macedonia and Poland, where volatility is relatively low in the pre-crisis period, largely due to prudent macroeconomic policies and the absence of significant vulnerabilities in individual sectors of the economy. In the post-crisis period, the volatility of growth across the region reduced significantly, which in part is probably a reflection of the adequacy of the monetary-fiscal mix implemented during the crisis and in the post-crisis period.

What are the challenges that remain for the policy makers in the CESEE region?

Regarding monetary policy, until the end of the previous year, in conditions of already positive output gaps and their potential impact on inflation, the need for increased vigilance in this segment, timely response towards policy "normalization", as well as preparation for gradual abandonment of unconventional instruments in the countries where they were used (the Czech Republic, Hungary, Poland and Romania) were highlighted. Higher uncertainty over future growth, as well as continued central bank stimulus policy in developed economies in the second half of 2019, suggest that **both the room for, and the need for, adaptive and stimulating monetary policy in the CESEE region are still present.** The average interest rate of the central banks of the CESEE region in 2019 is still positive, indicating that there is a room for further relaxation of the monetary policy in the region. At the same time, some countries in the region still maintain positive spreads in relation to the ECB interest rate, which is also in support of the adjustable monetary policy (Chart 3). In our economy, in 2019 the key interest rate equaled 2.25%, which makes the Macedonian economy to be among the countries with relatively wider spread relative to the ECB interest rate (2.25 percentage points). However, any further monetary relaxation in the region should be carefully designed while taking into account both the effects on savings and financial stability, if propensity for risk taking increases. When it comes to the cost of lending and savings yields, there has been a trend in the region of decreasing interest rates



on both loans and deposits in recent years. Thus, the average interest rate on loans reduced to 4.9% in the first half of 2019 (from 8.2% in 2013), while the average interest rate on deposits in the same period amounted to 0.9% (compared to 3.3% in 2013).

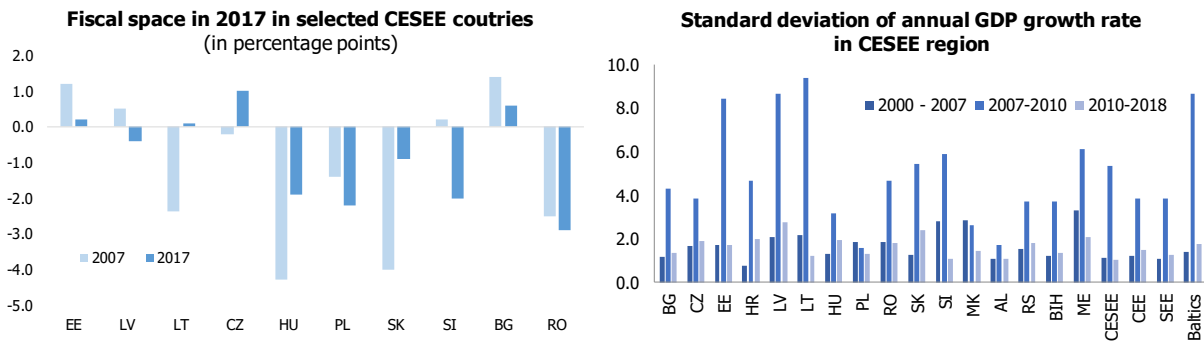
Chart 3

Source: ECB, central banks of individual economies and own calculations.

In the area of fiscal policy, it is necessary to continue the process of consolidation, in order to attain the medium-term fiscal targets. The overall budget deficit in the region, as previously noted, follows a downward trend. Observed by group of countries, in the Central and Eastern Europe (CEE) deficit decreased from 6.1% of GDP in 2009 to only 0.3% of GDP in 2018, in the Baltic countries from 6.2% of GDP in 2009 to 0.2% of GDP in 2018, while in Southeast Europe (SEE) from 4.1% of GDP in 2009 to 1.4% of GDP in 2018. Also, all countries in the CESEE region (with the exception of Montenegro) in 2018 have a budget deficit lower than the Maastricht budget deficit criterion of 3% of GDP. On the other hand, the structural indicators for the fiscal position indicate that some of the countries in the CESEE region in 2017 have a less favorable position compared to the pre-crisis level, i.e. 2007 (Chart 4). Namely, in 2017 most of the countries in the region with available data for this indicator have a less comfortable position than in 2007 (less positive fiscal space) or are still in the negative zone as in 2007 (fiscal space is negative). Gross public debt in the region is still within acceptable limits and is generally below the Maastricht criterion of 60% of GDP (with the exception of Albania, Croatia, Hungary, Montenegro and Slovenia), simultaneously registering a decrease in recent years. In the medium run, however, the burden on public finances is expected to be significant, especially given the accelerated aging process of population, as well as the negative migration trends in some countries in the region that are expected to generate new pressures on public finances (lower tax revenues and higher spending on health care and pension insurance in the medium term), which in turn points to the need to exercise a prudent policy regarding current borrowing.



Chart 4



Source: On fiscal space for the 2017 European Fiscal Board Annual Report, September 2019; for 2007 European Commission - Public finances in EMU - 2008; IMF Public Debt, World Economic Outlook - database.

In summary, during the global economic crisis, both policies were generally stimulating, providing support for economic growth while maintaining macroeconomic stability in the region. Currently, in conditions of low and stable inflation in the region, monetary policy remains stimulating. The relaxation of the ECB's monetary policy during 2019 creates additional room for the central banks in the region, and the relaxation would still be conditioned by the specific circumstances of each economy. In terms of fiscal policy, the public finance consolidation process has begun, but further approximation to medium-term fiscal targets and the creation of additional fiscal space is needed, which will strengthen the capacity to respond to potential future shocks.